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Question A:

FIDELITY DISCOUNTS AND REBATES NOT JUSTIFIED BY THE COSTS: IN WHICH CASE SHOULD A DOMINANT ENTERPRISE BE FORBIDDEN SUCH PRACTICES?

German National Report

by

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German competition law prohibits abuses of dominant positions (Sec. 19 Act against Restraints of Competition (hereinafter referred to as *"ARC"*)) and, by a special provision, discrimination and unfair hindrance (Sec. 20 (1) ARC). Sec. 20 (2) ARC provides that the Sec. 20 (1) ARC prohibitions also apply to “market-strong” undertakings when small or medium-sized undertakings, as suppliers or purchasers, depend on the "market strong" undertakings and no sufficient or reasonable possibilities for resorting to other undertakings are available. This can also apply to “fidelity” discounts and rebates.

1) Definition of fidelity discounts

1.1 Are you aware of any decision/judgement in your jurisdiction providing a definition of "fidelity" discounts as opposed to other types of discounts? Please describe.

Germany has well established case-law relating to discount policies. "Fidelity" discounts have been defined by the Higher Regional Court of Berlin (hereinafter Kammergericht (KG), 1980-11-12, WuW/E OLG 2403 *"Fertigfutter"*) as discounts granted when a consumer purchases almost all the products he requires from a sole supplier with a dominant market position and the granting of such discounts does not depend on the amount of the relevant order or the volume of overall supply. A purchaser that does not purchase all the products he needs from the supplier may not receive any discount at all. Therefore, such discounts are generally unrelated to any economic benefit for the supplier, since they do not derive from economies of scale. Rather, they act an incentive for the customer aimed at restricting the customer's purchasing decisions. Such discounts hinder any competitors on the market by way of compelling the consumer to purchase all their products from the dominant supplier in order to obtain the benefit of the discount. Hence, it is acknowledged that "fidelity" discounts guaranteed by dominant undertakings infringe competition law. However, according to the Higher Regional Court of Berlin, discounts that relate purely to the volume of supply are allowed if they have no negative effects on competition.

2) Cost justification

2.1 Are you aware of any decision/judgement in your jurisdiction discussing evidence of the cost justification underlying a discounting policy? Please describe.

For the Federal Court of Justice (hereinafter FCJ; Bundesgerichtshof (BGH), 2002-9-24, WuW/E DE-R 984 *"Konditionenanpassung"*), discounts are generally regarded as a legitimate part of competition in action. Discounts which only depend on the factual economic benefit of the amount of the supply – so called "volume" or "quantity" discounts – do not violate competition law if they match the cost advantages for the supplier and are granted without high levels of increments. Some cost advantages for the supplier are set out in the *Fertigfutter* decision of the Federal Cartel Office (hereinafter FCO; Bundeskartellamt (BKartA), 1979-10-22, WuW/E BKartA 1817 *"Fertigfutter"*), e.g. advantages due to economies of scale or lower administration costs.

Furthermore, "functional" discounts which only compensate the costs that the purchaser incurs instead of the supplier e.g. for the stock keeping, advertising, contingency reserves liability, customer service or care of the assortment of goods are also permitted by the FCJ (BGH, 1979-2-24, WuW/E BGH 1429 *"Asbach-Fachgroßhändlerverträge"*; BGH, 1962-9-27, WuW/E BGH 502 *"Treuhandbüro"*). The FCJ emphasizes that "functional" discounts will not infringe competition law if they reflect an economic benefit for the supplier. This conclusion suggests that, in general, the supplier of the goods has to bear the costs outlined above such as advertising, product assortment and/or the customer service. As the supplier receives an economic benefit if the purchaser covers these costs, competition law should not prohibit the supplier from returning some of the benefit to the purchaser.

Discounts that depend on the achievement of a long term turnover-target are in general forbidden if the target setting takes place at the beginning of the time period. The Higher Regional Court of Berlin (KG, 1980-11-12, WuW/E OLG 2403 *"Fertigfutter"*) has decided that, in general, a discount based on a time period of one year will infringe competition law.

Such discounts will act as an incentive for the customers effectively hindering competitors on the affected market. Furthermore, such discount policies can cause particular "pull effects" for markets other than those affected where the undertaking is dominant. For example, if the discount depends on the overall supply of all goods produced by the dominant undertaking. The purchaser will want to try to reach the overall turnover-target and, therefore, purchase additional products from the dominant undertaking on markets in which the undertaking is not dominant. The Court underlines that, of course, such discounts have some cost advantages for the supplier. But these advantages are not an adequate justification of the above mentioned negative effects on third markets. However, with respect to the time periods which are under consideration for the discount turnover-target, the Court has been prepared to accept time periods of some weeks or even months. This is a question that can only be assessed on a case-by-case basis.

3) Price discrimination

3.1 In your jurisdiction may price discrimination by a dominant firm violate antitrust law? If so, how is that discrimination defined? In particular, is this discrimination prohibited per se or only in as much as it actually distorts competition in the market? Please describe.

In general, negotiation on price and conditions is a normal part of competition. Each competitor can determine its prices and conditions (including discounts) by whichever method it prefers. Therefore, striving for the best prices and conditions is, according to the FCJ, an immanent part of competition and every market participant, including dominant undertakings, may try to acquire customers with attractive offers (BGH, 1996-3-19, WuW/E BGH 3058 *"Pay-TV-Durchleitung"*). However, in Germany undertakings with a dominant market position are subject to Sec. 19 and 20 ARC and are subject to special rules regarding their market behaviour.

Sec. 19 ARC prohibits the abuse of a dominant market position. Sec. 20 (1) ARC prohibits discrimination and unfair hindrance. Each section sets out different normative elements:

The assessment of discounts falls under the category of Sec. 19 (4) no. 1 ARC which provides that:

> *"an abuse exists in particular if a dominant undertaking, as a supplier or purchaser of certain kinds of goods or commercial services, impairs the ability to compete of other undertakings in a manner affecting competition in the market and without any objective justification.*"

"Other undertakings" in this context are competitors as well as undertakings on the down- and upstream markets, e.g. customers and suppliers. However, according to the FCJ, Sec. 19 (4) no. 1 ARC protects "other undertakings" on the directly affected market as well as undertakings on third markets if there is a causal connection between both markets. Therefore, its scope is relatively wide (BGH, 2003-11-4, GRUR 2004, 255 *"Strom und Telefon I"*). The most important aspect when assessing the abuse of a dominant market position is the question of objective justification. For example, the saving of supply costs due to the higher quantity of the order or the (partial) shifting of the benefits to the purchasers can in general be used as a justification. But as mentioned above there is no objective justification if a discount does not depend on the amount of the supply (e.g. "fidelity"

discounts). Sec. 19 (4) no. 1 ARC does not confer complete individual legal protection and requires an effect on competition in the market.

Furthermore, Sec. 20 (1) ARC prohibits price discrimination and unfair hindrance such that:

> *"dominant undertakings shall not directly or indirectly hinder another undertaking in an unfair manner in business activities which are usually open to similar undertakings, nor directly or indirectly treat it differently from similar undertakings without any objective justification.*"

The normative element of the prohibition of unfair hindrance comprises any "unfair" behaviour of a dominant undertaking that has an effect on the economic freedom of the affected undertakings (BGH, 2001-12-12, GRUR 2002, 831 *"Förderung der regionalen Wirtschaft"*). The most important part of the prohibition on discrimination is the objective justification. An unequal treatment of undertakings must be considered discriminatory, if balancing the affected interests of the undertakings against the purpose of competition law shows that the behaviour is unjustifiable (BGH, 1962-9-27, BGHZ 38, 90 *"Treuhandbüro"*). A discount policy could be affected by this prohibition if it treats equivalent undertakings differently. Therefore, discounts by dominant companies must depend on uniform requirements, and purchasers of the same quantities in general must get the same discount. According to the case-law of the FCJ and the FCO there is no clear separation between the alternatives of Sec. 20 (1) ARC (e.g. BGH, 1979-2-24, WuW/E BGH 1429 *"Asbach-Fachgroßhändlerverträge"*). Sec. 20 (1) ARC affords individual legal protection. Hence, it does not explicitly require a distortion of competition in the market, but discrimination or an unfair hindrance of another undertaking.

3.2 Are there rules in your jurisdiction that prohibit price discrimination irrespective of the market power of the firm involved? Can you briefly describe these rules and discuss how they are interpreted?

As mentioned above, only undertakings with a dominant market position are subject to Sec. 19 and 20 (1) ARC. However, according to Sec. 20 (2) ARC the provision of Sec. 20 (1) ARC also applies to undertakings, irrespectively of their market shares, which are so-called "market-strong", i.e. upon which small or medium-sized undertakings as suppliers or purchasers are dependant as the possibility of resorting to alternative undertakings does not exist. German law regarding unilateral behaviour of discrimination and unfair hindrance is therefore stricter in this respect than EU law.

According to Sec. 20 (4) ARC the prohibition of unfair hindrance also affects undertakings with "superior market power" in relation to small and medium-sized competitors. They shall not use their market position directly or indirectly to hinder such competitors in an unfair manner. There is no definition of "small and medium-sized competitors". The interpretation, however, depends on the situation on the affected market in each case. According to the Higher Regional Court of Düsseldorf (OLG Düsseldorf), Sec. 20 (4) ARC was established especially with respect to unfair pricing and discount policies towards small and medium-sized competitors of undertakings with concentration of buyer power (OLG Düsseldorf, 2002-2-13, WuW/E DE-R 829 *"Freie Tankstellen"*).

4) Exclusionary nature of "fidelity discounts"

4.1 In your jurisdiction is indirect evidence that market shares of competitors (and especially market shares of complainants) were not affected by the discounting policy sufficient to rule out its allegedly exclusionary effect? Please describe.

In the context of Sec. 19 (1) and 20 (1) ARC according to the standard burden of proof the undertaking which is affected by the discounting policy has to prove the normative requirements. Otherwise, the objective justification for the discrimination in the context of Sec. 20 (1) ARC must be proven by the discriminating undertaking (BGH, 1990-11-13, WuW/E BGH 2683 *"Zuckerrübenanlieferungsrecht"*). However, the unfairness of the hindrance in the context of Sec. 20 (1) ARC has to be proved by the supposedly affected undertaking. This difference between both prohibitions of Sec. 20 (1) ARC depends on the situation that regarding the discrimination the balance of interests in the context of the objective justification has a negative indicative effect. Therefore, the FCJ (BGH, 1990-11-13, WuW/E BGH, 2683 *"Zuckerrübenanlieferungsrecht"*) established a shifting of the burden of proof in this respect.

The deterioration of the market situation or the market shares of competitors are neither indirect evidence for an abuse of a dominant position, nor, on the contrary, sufficient indirect evidence to rule out the allegedly exclusionary effect of a discount policy. However, before the coming into effect of Sec. 19 (4) no 1 ARC the jurisdiction of the Higher Regional Court of Berlin required a significant deterioration of the market situation (KG, 1978-4-14, WuW/E OLG 1983 *"Rama Mädchen"*). The problem with this approach was that the possible deterioration of the market situation could only occur after the behaviour had come to an end and, therefore, too late for a timely reaction against the anticompetitive behaviour. Therefore, today the need for a deterioration of the market situation or the market shares of the competitors is not required, but, of course, an effect on competition in the market is required.

With regard to the prohibition of hindering small and medium-sized competitors by a company with "superior market power" according to Sec. 20 (4) ARC (see question 3.2), Sec. 20 (5) ARC creates a presumption that the undertaking has used its market power within the ruling of Sec. 20 (4) ARC. Therefore, the undertaking with superior market power has to rebut the presumption, and clarify such circumstances in its field of business on which legal action may be based, and which cannot be clarified by the competitors concerned. In special circumstances this rule shall also apply analogously to the hindrance element of Sec. 20 (1) ARC if the circumstances of the business cannot be clarified by the affected competitors.

4.2 In your jurisdiction is the exclusionary nature of discounts proved through a comparison of costs and revenues? If not, how else is such exclusion assessed?

Under Sec. 19 (1) and 20 (1) ARC discount systems could be classified as forbidden low-price policies. According to the Higher Regional Court of Berlin (KG, 1980-11-12, WuW/E OLG 2403 *"Fertigfutter"*) the exclusionary nature of a discount policy can be indirectly ascertained through a comparison of costs and revenues. The Higher Regional Court stressed that in general "fidelity" discounts have an exclusionary effect because competitors of the dominant undertaking are not able to give the same discount without a decrease of their gains. Therefore, the Higher Regional Court explains the exclusionary effect as follows: Because of the increase of the disbursed discount, the actual discount regarding

the latest supply, granted irrespectively of the costs and the revenues of the supply, is very high; particularly in comparison with the possible (economically reasonable) discount of a competitor, which has to be economically in connection with the costs and revenues of the competitor. The discount of the dominant undertaking regarding the separately considered single supply is unjustified from an economic point of view, and has no equivalent reward. Therefore, the competitors are not able to grant the same high discounts as the dominant undertaking and, hence, the customer will not order from other competitors, unless they give him the same (uneconomical) discounts.

Furthermore, according to the FCJ (BGH, 1985-12-10, WuW/E BGH 2195 *"Abwehrblatt II"*) setting a price below the supplier's own costs which does not bear the commercial fundamentals in mind can be an abuse. However, prices below the supplier's own costs can be objectively justified because of the special circumstances on the market (e.g. advertising) or of the relevant products (e.g. perishable goods).

Sec. 20 (4)(2) ARC also applies to discount policies if the sale price is, due to the discount, actually below the cost price without an objective justification. In the case of Sec. 20 (4)(2) ARC undertakings with superior market power in relation to small and medium-sized competitors shall not sell their goods under the cost price unless this only happens occasionally. With respect to Sec.20 (4) ARC in December 2007 the German legislature has changed the conditions of the objective justification for selling foodstuffs under the supplier's own costs. In the updated version, the selling of foodstuffs below cost price of the supplier is only justified regarding perishable foods if the products cannot be sold at a later date, irrespectively of the duration of the offer, i.e. the prohibition may also apply when selling only occasionally below cost price.

4.3 Should your jurisdiction perform a comparison of cost and revenues, what is the definition of costs that is used, average variable, average total, incremental or marginal? Please describe.

As mentioned above, in the German (published) jurisdiction there has not been any explicit comparison of costs and revenues so far. Of course, regarding the battle for the lowest price between competitors the jurisdiction has given consideration to the calculation of the prices. According to the FCJ the sales price must be "commercially acceptable" (BGH, 1985-12-10, WuW/E BGH 2195 *"Abwehrblatt II"*). But a comparison of costs and revenues equivalent to the European Court of Justice (e.g. ECJ, 1991-7-3, Rec. 1991, I-3359 *"AKZO"*) has not yet been established in Germany. In this respect the definition of the cost price in the context of Sec. 20 (4)(2) ARC means, according to the FCO, the catalogue price of the manufacturer (without value-added tax) minus all price relevant conditions which have their reasons in the contractual relationship between the supplier and the purchaser (e.g. discounts, yearly target agreements, benefits for marketing and selling, etc.).

4.4 Furthermore in your jurisdiction are the relevant costs over which the comparison is undertaken the costs of the dominant firm or the cost of the excluded competitor? In any case, are there instances where an above costs abuse was identified in your jurisdiction? Please describe.

Sec. 19 and 20 ARC refer to the costs of the dominant undertaking. However, the assessment of the discount policy does not only depend on the costs rather on an overall

view of the market behaviour (BGH, 1985-12-10, WuW/E BGH 2195 *"Abwehrblatt II"*). Currently, after the coming into effect of the provision regarding the below cost price in Sec. 20 (4) ARC in 1998, there are no obvious decisions in which the FCJ has identified an above costs abuse.

4.5 In your jurisdiction what is the relevant output over which the exclusionary effect of discounts is calculated and, in the case of bundled discounts, which is the relevant revenue over which the exclusionary effect of discounts is calculated? Please describe.

According to the FCJ (BGH, 1985-12-10, WuW/E BGH 2195 *"Abwehrblatt II"*) the relevant output for the categorisation of a discount policy as exclusionary is the borderline to the competition on performance, irrespective of the undercutting of the conditions of the competitors. The undercutting of the conditions of the competitors is not per se exclusionary, rather a typical competitive conduct and, hence, not a violation of the competition law. This rule applies, according to the FCJ, even if the dominant undertaking intends to crowd out its competitors from the affected market. Only if there is a further anticompetitive behaviour of the dominant undertaking, can the undercutting be declared as a violation of competition law. However, as mentioned before, according to the provision in Sec. 20 (4) ARC the prices may not be below cost prices.

5) Justifications for exclusionary discounting policy

5.1 Once a discounting policy is proved to be exclusionary, are there instances where the competition authority accepts justifications by the dominant firm as for the legality of the discounting strategy, and if so which justifications have greater probability of being accepted? Are these justifications relevant for the identification of the abuse, for assessing the level of a possible sanction or for both? Please describe.

In German competition law, the objective justification as well as the unfairness is structurally part of the normative elements of Sec. 19 (4) no.1 and 20 (1) ARC. Therefore, the justifications are relevant for the identification of an abuse as such. If the behaviour is objectively justified, there is no abuse of competition law. So the amount of the sanction depends not directly on the justifications, but on the complete facts of the case (including the reasons for a justification) as such.

In general, discount policies which depend on the amount of the single order or the overall demand of a specific product of one customer and, therefore, depend on the economies of scale of the supplier, are, in general, objectively justified (BGH, 2002-9-24, WuW/E DE-R 984 *"Konditionenanpassung"*). By contrast, discount policies which intend to tie purchasers to a supplier in order to obstruct the possibility to buy products from other suppliers are not objectively justified and violate competition law. According to the Higher Regional Court of Berlin such discounts have a pull effect and exclude the competitors from the relevant market preventing competitors from selling their products to the purchasers on the market (KG, 1980-11-12, WuW/E OLG 2403 *"Fertigfutter"*).

6) General / Additional comments

6.1 Does the topic raise any special or additional issue in your jurisdiction, apart from the matters already covered in your answers to the questionnaire?

It should be mentioned that Article 82 EC Treaty (hereinafter Treaty) affects discount policies in a similar manner to Sec. 19 and 20 ARC. The definition for the dominant market position in the EU law is similar to the definition in Sec. 19 (2) ARC. However, the rebuttable presumption in Sec. 19 (3) ARC – esp. single market dominance with a market share of 1/3 – has no counterpart in EU law. But the scope of application of the rebuttable presumption is limited: in civil law cases the rebuttable presumption only has an indicative effect and initiates no real shifting of the burden of proof. Regarding administrative proceedings the FCO has to prove the requirements of the presumption (i.e. the market shares of the respective undertaking) and the respective undertaking can rebut the presumption. Further, the rebuttable presumption does not apply in relation to proceedings for administrative fines.

Furthermore, there is no parallel legislation under EU law which is similar to the above mentioned Sec. 20 (2) ARC – the prohibition of discrimination and unfair hindrance of dependent undertakings by "market strong" players – and to Sec. 20 (4) ARC – the prohibition of unfair hindrance of small and medium-sized competitors by undertakings with "superior market power". In this respect German competition law is tougher than EU competition law. According to Article 3 (2)(2) Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty this difference regarding unilateral behaviour is accepted by EU law.

6.2 Any concluding remarks?

In November 2007 the FCO remitted fines against the airtime-agents of the TV stations RTL and Pro7Sat1 because of a breach of German competition law. According to the FCO the undertakings practiced an anticompetitive discount system in relation to agreements with media agencies and advertisers. Currently the decision is not published and, therefore, there is no more information officially available. However, there is an assumption that the FCO adopted the case law of the European Court of Justice and the European Commission by comparing costs and revenues.

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