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European anti-trust restrictions on rebates and discounts by "dominant" companies

As consumers, we often benefit from reduced prices, rebates, discounts, reduction coupons and loyalty coupons of various sorts. However, European anti-trust authorities, acting under the pretext of preserving competition, have been moving against these trade practices and price variety – judging them "discriminatory" – especially when applied by "dominant" firms. Contrary to its stated aim, this competition policy penalizes consumers by depriving them of lower prices and better service. Rather than protect competition against an "abuse of dominant position," it shelters inefficient competitors.

The "price discrimination" sanction in the EU

The use of price rebates and discounts by companies found to be in a "dominant position" can come directly under the sanction of Article 82(c) of the Treaty instituting the European Community.[1] This section in effect prohibits them from "applying dissimilar conditions to equivalent transactions with other trading parties (...)."[2]

"Dissimilar conditions" include the supposed existence of "price discrimination". This consists of "charging different prices for different units and/or to different customers."[3] A business would have to apply the same price – or even the same discount – to different customers if the product or service it is offering is found by the anti-trust bureaucrats to be identical, even though it may not be so in reality.

> "Anti-trust authorities have prohibited numerous companies from offering their customers lower prices in the form of discounts, price rebates, bonuses, preferential prices or loyalty coupons."

For example, Michelin was punished for offering its dealers a bonus system based on total turnover and on the quality of their equipment and after-sales service.[4] Thus, not even rebates based on higher sales volumes – when buying higher volumes, you can generally expect a rebate – or on a reward for higher-quality service to the final consumer, seem safe from the European Commission.

Michelin was not alone in seeing its volume rebates punished. A company such as British Airways was punished for offering rebates to travel agents based on their ticket sales. Similarly, a company selling sugar (Irish Sugar), was prohibited from offering discounts based on growth in its customers' purchasing volumes.[5]

The Commission also prosecuted companies offering different prices in other forms. For example, United Brands and Tetra Pak were convicted for offering different prices for their products – bananas and aseptic cartons intended for the packaging of liquid foods respectively – in

1. Other sections in the Treaty may also be used by the European Commission or by the Court of Justice of the European Communities to sanction "discriminatory pricing." This includes Article 81, aimed at exclusivity contracts. Such contracts often involve different pricing based on geographic location, depending on the country. On this topic, see the Economic Note from the Institut économique Molinari on the Grundig case titled "The banning of vertical agreements in Europe: an anti-competitive policy," available at http://www.institutmolinari.org/pubs/note20072.pdf.
2. See the Treaty establishing the European Community, available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/ce321/ce32120061229en00010331.pdf.
3. See the report of the Economic Advisory Group for Competition Policy (EAGCP), "An economic approach to Article 82," 2005, p. 30, available at http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf.
4. See Denis Waelbroeck, "Michelin II: A per se rule against rebates by dominant companies?," *Journal of Competition Law and Economics* 1(1), 2005, p. 150, available at http://jcle.oxfordjournals.org/cgi/content/abstract/1/1/149.
5. See Damien Geradin and Nicolas Petit, "Price Discrimination under EC Competition Law: The Need for a case by-case Approach," Global Competition Law Centre, *Working Paper*, 2005, pp. 13-14, available at http://www.coleurop.be/content/gclc/documents/GCLC%20WP%2007-05.pdf. See also the version published in the report of the Swedish Competition Authority titled "The pros and cons of price discrimination," 2005, pp. 21-64, available at http://www.kkv.se/upload/Filer/Trycksaker/Rapporter/Pros&Cons/rap_pros_and_cons_pricediscrimination.pdf.

different countries.

According to a specialist in competition matters, in the EU "there is a general tendency to simply presume systematic anticompetitive effects in the case of any rebate scheme of a 'dominant company' and to underestimate their pro-competitive effects."[6]

"The existence of multiple prices may be perfectly justified from an economic standpoint, even if public authorities seek punishment by calling them 'discriminatory.'"

Community authorities have extended the scope of Article 82(c) and are moving also against trade practices, with cases resting on the application of "similar conditions" to transactions judged as "non-equivalent." A "dominant" company could thus be punished, for instance, for offering the same unit price or the absence of discounts in the sale of different quantities – or a different presentation – of the same product to different customers.[7]

In brief, the Community's anti-trust authorities have prohibited numerous companies – operating in fields ranging from drugs, tyres and aseptic food containers to nails, bananas, ice cream or sugar (see Table 1) – from offering their customers lower prices in the form of discounts, price rebates, bonuses, preferential prices or loyalty coupons.

represent the same value to the parties involved in the transaction.

Multiple prices can bring many advantages. From the start, there are the direct and immediate advantages to customers who pay less because of discounts, rebates or reduction coupons.

But there are also advantages for companies, whether or not they are dominant. Authorities seem to forget that sellers always seek to get the highest possible prices and that, if firms make price concessions, it is because they expect it will serve their interests.

First, for example, they can make price concessions based on volumes purchased. This reflects the fact that sellers save on resources and can lower their costs when large volumes are sold in a single transaction. If they had to look for new customers and promote their products each time, they would doubtless have to invest more and devote additional resources to succeed in selling the same quantity of merchandise. Forbidding discounts amounts to preventing this cost reduction that benefits the buyer as well as the seller.

Table 1: Examples of companies prosecuted for "price discrimination"

Company	Type of business	Trade practice covered
Michelin	tyres	bonuses for dealers
Hoffmann-La Roche	vitamins	discounts for buyers
United Brands	bananas	lower prices in certain countries
Irish Sugar	sugar	discounts for some targeted wholesalers
Hilti	nails	selective price reductions
Van den Bergh Foods	ice cream	free or reduced-priced freezers for the sale of ice cream of their brand
Tetra Pak	aseptic food containers	lower prices in certain countries
British Airways	air transport	discounts for travel agents
British Plasterboard Industries	plasterboard	discounts for customers

Source: Damien Geradin and Nicolas Petit, 2005, *Op. cit.*

The economic role of "price discrimination"

The existence of multiple prices may be perfectly justified from an economic standpoint, however, even if public authorities seek punishment by calling them "discriminatory." In fact, offers that may seem "equivalent" to an outside observer may be different and may not

Second, multiple prices can be justified by the existence of various sub-markets or niches in which consumers are not prepared to pay the same price to obtain a given good or service. The use of rebates, reduction coupons or other price discounts – even offering a product free to make it known – is a means for a company to attack a new market niche by attracting consumers who otherwise would not have purchased the product at the usual

6. Denis Waelbroeck, 2005, *op. cit.*, p. 151.
7. See Geradin and Petit, 2005, *op. cit.*, p. 8.

price.

This trade practice is especially useful in sectors where it is indispensable for companies – prior to the final marketing of their product or service – to commit large amounts to invest in R&D, as in the case of the pharmaceutical sector, or in infrastructure, as with telecoms. In this type of situation, each new customer is welcome. Multiple prices provide for higher sales receipts and thus help recuperate these costs more easily. If the company had to impose a uniform price, some consumers would simply not buy the product and would be excluded, making it harder for the company to finance the required investments.

"'Price discrimination' is the very expression of competitive pressure in the market. If a firm offers discounts or rebates, its competitors have a strong incentive to react by lowering their own prices or by improving the quality of their products."

Finally, in attempting to serve the final consumer better, a company may also use "price discrimination." As in the case of Michelin, a manufacturer may institute a bonus system for its dealers based on qualitative factors, such as the quality of after-sales service or assistance, to encourage them to offer more. Punishing these practices comes down to depriving companies "of the possibility to reward the increased quality of the service of their distributors."[8] Anti-trust regulations thus end up resulting in lower quality for consumers.

Some wholesalers or retailers must also establish bonuses to encourage suppliers to ensure stable and regular supplies to the benefit of consumers. In Australia, for instance, milk producers are offered bonuses if they agree to provide a steady year-round supply, despite natural seasonal variations in production.[9] In such cases, challenging the bonus system can harm an industry's stability of supply.

"Price discrimination" favours competition

European authorities penalise the use of price "discrimination" because it could result in competition being choked off by excluding certain rival firms or keeping them out of the market. To prevent a "dominant" firm from gaining a monopoly, it is appropriate in the opinion of Brussels to prohibit discounts, rebates and other price cuts.

But in the absence of any legal prohibition to entry, any potential rival is welcome to come in and compete against the "dominant" firm – even against a firm that is alone in its niche. And rivals will not hesitate to do so if there are opportunities to satisfy customers better. Free competition depends on the absence of legal barriers to entry and not on anti-trust prohibitions of discounts and rebates.

By offering better service and lower prices to consumers, a firm using price "discrimination" in a context of free competition tends to increase its sales volume and to raise its market share accordingly. Even if the firm is "dominant," this in no way detracts from the fact that it continues to provide these same services to its customers.

In fact, "price discrimination" is the very expression of competitive pressure in the market. If a firm offers discounts or rebates, its competitors have a strong incentive to react by lowering their own prices or by improving the quality of their products to the benefit of consumers. They have all the more incentive to do so by dint of the fact that the process was initiated by the "dominant" firm, in other words the company that captured the loyalty of a large part of the customer base. In reality, rebates and other price discounts do not threaten competitive pressures but, on the contrary, intensify them.

European anti-trust policy prevents free competition

Beyond the fact that anti-trust legislation on rebates and discounts penalizes transactions that are mutually beneficial to buyers and sellers, it also presents two added perverse effects.

On the one hand, it brings an arbitrary element and a degree of uncertainty into the business environment. Instead of letting the parties involved in a transaction judge if what is offered is "equivalent" or if conditions are "dissimilar," the legislation entrusts this task to outside observers who cannot fulfil it correctly in their place.[10]

8. See Damien Geradin and Nicolas Petit, 2005, *op. cit.*, p. 23.
9. See Valentin Petkantchin, "Reforming dairy supply management in Canada: the Australian example," Economic Note, Montreal Economic Institute, January 2006, p. 4, available at http://www.iedm.org/uploaded/pdf/janv06_en.pdf.
10. See also Damien Geradin and Nicolas Petit, 2005, *op. cit.*, p. 8, who emphasize by the way that "both the Commission and the Courts generally assume that two transactions are equivalent without much analysis."

Prices and conditions negotiated in a transaction depend, in contrast, on a multitude of factors that the contracting parties may or may not consider pertinent. Transactions covering physical goods or services that may seem "equivalent" to an outside observer may not seem so to the firms selling them or to customers buying the goods or services. A simple detail, such as knowing whether a partner has a reputation for always being solvent or if bills are never paid on time, may be important enough in a transaction to justifying a firm deciding to treat one partner differently from another.

It gets worse. According to European regulations, it is impossible to know what action to take in similar cases. Any decision by a "dominant" firm, whatever that decision may be, could find itself challenged and punished by the anti-trust authorities.

"Anti-trust policy on 'price discrimination' diminishes rather than protects competition in an industry – to the detriment of consumers."

In effect, if two business partners are treated the same way, there could be accusations of discrimination and of treating "non-equivalent" transactions equally. But in contrast, applying different prices is just as likely to result in the firm being prosecuted for discrimination if the European authorities judge that the factors at issue (a reputation for solvency for example) have no value in their eyes, even if the parties involved in the transaction view them differently! Regulations on price discrimination are thus fundamentally arbitrary, and they increase the uncertainty of the business environment for companies.

On the other hand, anti-trust legislation has provided a means of punishing more efficient competitors.

The legislation set out in Article 82(c) as formulated is supposed to provide protection to customers of a firm that practices "price discrimination."[11] But despite this, these European regulations have often been used to protect direct competitors of the dominant firm. Competitors have preferred to turn to the public authorities to neutralize their rivals' discounts and price cuts rather than adapting to a changing market and trying to serve consumers better. Why strive to hold onto customers if anti-trust legislation can be used to prevent a competitor from attracting these customers by means of better offers and lower prices?

Anti-trust policy on "price discrimination" thus diminishes rather than protects competition in an industry – to the detriment of consumers.

Conclusion

European anti-trust authorities punish trade practices based on the use of "price discrimination" such as rebates, discount coupons, premiums or preferential prices when used by "dominant" firms.

Far from being a threat to competition or representing an "abuse of dominant power," such practices are a means of increasing competitive pressure in the market. By punishing them, anti-trust legislation protects inefficient firms and prevents consumers from enjoying lower prices.

11. As indicated by Damien Geradin and Nicolas Petit, 2005, *op. cit.*, p. 9, "parties Article 82(c) seeks to protect are the customers of the dominant player and not its competitors. Literally all legal scholars seem to agree on this point."

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