



Lademann & Associates Economists and Competition Consultants

Rebate Systems in the Focus of Competition Authorities

The Path to a Competition Law-Compliant Rebate Policy





Customer Loyalty – Success or Risk Factor?

Target sales, loyalty discounts, performance bonuses, and reimbursements are common practice in many sectors. They are used to stabilise the relationship between suppliers and customers as well as to promote customer loyalty. However, these initiatives are being targeted by competition authorities. The steering and incentive function of retroactive rebates can strengthen a business relationship in such a way that the market is blocked for other suppliers (foreclosure and suction effect).

From a competition law perspective, discounts become critical if they are practised by companies holding a dominant position in the market and if they give rise to loyalty-inducing or “suction” effects. In addition to this, and not less critical, a supplier may leverage his market power from one relevant product market to another, where he has no market power, by applying bundled rebates.

Examples of possibly critical discounts

- Suppose a company is dominant in a market. It grants its customers a discount on total turnover, given that they reach a certain turnover threshold within a year. Above a certain discount amount, this practice could effectively lock out sections of the market to competitors.
- Suppose a company sells two different products and is dominant on one of the markets. Customers who purchase both products are granted a discount if they reach a certain total turnover threshold with both products. In such a scenario, it can be sufficient that the rebate is granted on total turnover to give rise to anti-competitive market foreclosure. The reason for this is that customers, who need to purchase the product from the dominated market anyway, may find themselves confronted with a situation in which they only need to make low additional sales with the non-dominant product in order to get the discount on all sales.

High fines and the risk of damage claims

Competition authorities have repeatedly imposed high fines on anti-competitive discount schemes. They fine companies irrespective of whether they have merely practised industry customs by offering the specific rebates (sometimes even at the request of customers), or have introduced them with a predatory intent.

Following the new doctrine to strengthen private competition law enforcement, an abusive retroactive discount practice may additionally lead to drastic claims for damages from competitors.

Self-assessment rather than exemption

Companies with a strong market position are therefore required to check whether they could be regarded as dominant within the relevant market and, if so, to ensure that a retroactive discount system implemented by them does not trigger any exclusionary effects.

Since competition law has moved to the principle of self-assessment and exemption of certain business practices by competition authorities is no longer possible, companies bear the responsibility for a competition law compliant discount system themselves. They are faced with the challenge of simultaneously stabilising customer relationships and keeping within the limits of competition law.



Solving Competition Law Problems, Optimising Market Strategies

We help our clients to identify and assess any potential contravention of their discount policy with competition law. In the event of a likely conflict with competition law, we help them to redesign the critical discount elements using a proprietary IT tool especially developed for this purpose. Adapting the tool to the needs of our clients, we put them in a position to recognise critical rebate schemes themselves and maintain broad freedom of action in their daily business at the same time.

In doing so, we actively engage our customers and give them an instrument with which they can determine future competition law limits relating to retroactive discounts themselves. Close coordination and cooperation with internal and external lawyers is an integral part of our approach.

We also provide advice in cases where a company is likely to be foreclosed from a market by the discount practices of a competitor. Here we perform conceptual work in advance towards an action for injunction or damages.

Fines that have been imposed over the past few years due to retroactive target and loyalty discounts:

- **British Airways**
6.8 m euros, 1999, EU Commission
- **Michelin**
19.76 m euros, 2001, EU Commission
- **ICI**
10 m euros, 2003, EU Commission
- **Tomra**
24 m euros, 2006, EU Commission
- **IP Deutschland & Seven One Media**
216 m euros, 2007, Bundeskartellamt (Federal Cartel Office)
- **Intel**
1.06 bn euros, 2009, EU Commission

Retroactive rebates – View of the European Commission

- **Definition:** Retroactive rebates typically involve a (usually sales) target threshold and a discount being granted on all sales if the threshold is reached or passed. They differ from incremental rebates which involve discounts on sales above some predetermined threshold, but not on sales beneath the threshold.
- **Possible effect:** A part of a dominant firm's demand is usually not vulnerable to competitors (non-contestable). This is where the potential for abuse of a retroactive rebate system arises. A firm competing for the contestable share of demand has to compensate the customer for the lost rebate if the customer switches away from the dominant firm. If the discount offered is higher in value than the sales contested by competitors, this can lead to very low and even negative effective prices for the contestable portion of demand. As customers have to purchase a certain amount of sales (the non-contestable part) from the dominant firm anyway, they may already find themselves "close to the discount threshold". In such a scenario, the effective price can be so low that competitors cannot compete for the contestable share. The resulting suction effect and corresponding market foreclosure depends on the configuration of the rebate system and the respective market as well as on the competitors active in it. The European Commission considers the market-based consequences of such discounts by the "more economic approach" ie. the competition law assessment has to be based on the specific circumstances of the case at hand.

Project Plan and Phases



Lademann & Associates carry out projects modularly. Depending on the data conditions, quick checks could already provide enough clarity regarding rebate schemes which may be critical from a competition economics perspective. However, it can also be crucial to investigate the market and competitive situation as well as the definition of the relevant market more thoroughly.

The following project steps typically belong to a rebate-condition check:

- Firstly check if a dominant position exists: only the existence of a dominant position limits firms in their freedom to guarantee discounts.

In this step, the relevant markets are defined and the firm's position in each of the relevant markets is assessed.

- If a dominant position cannot be ruled out, or is to be expected in the near future, it is necessary to check the applied rebate system for its compliance with competition law.

In this step, we analyse the structure, rebate rate and the effects of the retroactive discount system. We clarify whether and to what extent competition limiting effects can originate from the system by applying the test set forth by the EU Commission (As Efficient Competitor Test)¹.

- If the retroactive discount system is likely to be in conflict with competition law, a redesign is necessary.

Still permissible discount thresholds and rates as well as product bundles, if necessary, are determined using a proprietary IT tool developed by Lademann & Associates.

Optional: Market definition

Optional: Assessment of dominance

Checking the discount system

Reconfiguration of the discount system

Continual support

Possible Checklist

- Train our customers to implement the IT tool themselves as part of an in-house solution.

This does not only include training on how to use the software, but more importantly how to recognise critical marketing schemes. Even after the end of the project, support is provided to the customers when required.

¹ Communication from the Commission — Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings

25 Years of Expert Knowledge in Competition Economics



We, Lademann & Associates, are the first German consulting firm to specialise in competition economics. Many of our customers are publicly listed and belong to the biggest players in their industry.



In current projects we are involved in key cartel and abuse of dominance proceedings. With this, we seamlessly connect with our many years of experience in German merger control and abuse of dominance proceedings as well as our supervisory participation in the 5th and 6th Amendment to Act Against Restraints of Competition.

Broad expertise in markets and the economy of law

We advise market leading companies from very different sectors. For example:

- Primary industries
- Automotive industry
- Consumer goods
- Network industries
- Wholesale and retail
- Transportation services
- Insurance industry

State-of-the-art methods

Combining rigorous economic thinking with state-of-the-art empirical techniques we are able to answer key questions in competition law proceedings and strategy development.

Multivariate econometric methods, market simulation programs and discrete choice analysis are part of our spectrum of methods. By cooperating with renowned universities we stay up to date both methodically and academically.

At the same time we put great emphasis on an exposition which is easily comprehensible also to non-economists.



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Your contacts

For a confidential initial appointment our experts are always happy to assist you:



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Knowledge matters.