

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

1) Definition of fidelity discounts

The question refers to fidelity discounts. “Fidelity” identifies a sub category of discounts, intended to provide either implicit or explicit compensation for loyalty (you buy only from me). In theory, “fidelity” discounts should be distinguishable from “quantity” discounts, the other sub category of discounts, where a seller provides compensation for large purchases. In practice, the distinction between “fidelity” and “quantity” discounts is much less clear, largely indirect and based on the “objective” justification of the provided discounts. If discounts are objectively justified (strictly cost based) then discount enhances fidelity only indirectly, since the discount passes down to customers the cost reductions originating from the purchase. In such cases discounts are unlikely to be considered fidelity discounts (see also point 2)

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

A) General

In the past years there were only very few decisions by the Hungarian Competition Office (“**HCO**”, the national competition authority of Hungary), that strictly related to fidelity discounts. Most of the relevant decisions concerned exclusionary pricing practices in general (price discrimination, margin squeeze, bundling) and only a few decisions related expressly to the question at hand.

The HCO took most of its decisions under Article 21 of Act XLII of 1996 on Competition (the Hungarian Competition Act, “**HCA**”), which prohibits the abuse of a dominant position. In addition, in cases where the effect on trade between member states could also be established, the HCO also relied on the relevant provision of the EC Treaty, namely Article 82. It is important to note that the distinction is not material as the wording of Article 21 of the HCA is essentially similar to Article 82 of the EC Treaty, and the HCO regularly interprets the HCA in line with the case-law and jurisprudence of the European Commission and the European Courts.

B) Early case-law

In an early case in 2002, the HCO – when analysing a certain discount provided by a dominant telecommunications company – already made a distinction between quantity discounts and “other” discounts, however, the HCO’s main focus was not the issue of fidelity rather the the issue of discrimination. The HCO stated that *“a so-called quantity discount provided by a dominant company – corresponding to the amount/quantity of the service [...] – can be regarded as legal if [such discounts] can be justified with objective reasons relating to economic of scale, that is if the higher volume of services ordered*

results in a demonstrable reduction of costs at the service provider” (Vj-87/2001 (Matáv), para 15.4). From the perspective of discrimination, the HCO identified the competitive problem as the distortion of competition on the downstream market: it noted that a discount not fulfilling the above criteria “could be illegal from a competition law point-of-view as it discriminates against those clients of the service provider are only capable of putting smaller orders” (id.) The decision is remarkable also from the aspect that - albeit at a descriptive part of the decision, discussing the report of the case-handlers - the HCO already used the term “fidelity discount” in relation to the above practices (Vj-87/2001 (Matáv), para 15.2).

In an early cases the HCO also considered that certain volume discounts may be abusive as they result in exclusivity and thus may have the effect of foreclosing competitors from the market (Vj-167/2001 (Magyar Posta). The case was special as it concerned leveraging of dominance from one market to another: the discounts were provided in one market in exchange for using the services of the Hungarian Post in another¹. The HCO expressly found that such discounts had a clear exclusionary effect and went on to state that volume discounts provided to customers can in general be regarded as an abuse of a dominant position unless they are transparent, non-discriminatory and objectively justified by reductions in cost (para 82, 87 of Vj-167/2001 (Magyar Posta)). Admittedly, in the given case, however, the HCO did not use the term “fidelity discount” nor it defined such discount. In a similar case regarding a discount used by a collectively dominant cement producer that was conditional on the customer not purchasing any import cement for onward sale, – where the notion of fidelity discount was again not mentioned expressly - the HCO found that such a discount had an exclusionary effect on other competing undertakings (Vj-73/2001 (Holcim/Duna-Dráva), para 111).

C) The leading case – definition of the main categories of discounts

The leading case of the HCO relating to a fidelity discounts was brought in 2006 and concerned certain preferential terms provided by the Hungarian Post to some of its largest customers in 2006 (Vj-174/2005 (Magyar Posta)). The HCO brought its decision both on the basis of Article 82 of the EC Treaty as well as its national equivalent, Article 21 of the HCA. Although the HCO did not provide a succinct definition of “fidelity discounts”, it did outline the main categories and relevant characteristics of such discounts in its decision, after having HCO referred to the judgment of the ECJ in C-85/76 (Hoffmann-La Roche) as well as the European Commission’s decision 2001/354/EC (Deutsche Post). The HCO’s decision also takes note of the European Commission’s discussion paper on exclusionary abuses as well as of the European Court of Justice’s judgment in T-203/01 (Michelin II). The HCO concluded that the essence of the competitive evaluation in such cases is a distinction between “fidelity discounts” and discounts clearly based on volume

¹ In the given case, two markets were concerned: the market for regular mail services in Hungary (where the Hungarian Post had a legal monopoly) and the market for printing special deliverables (such as invoices, notices, bank statements). The Hungarian Post provided special (and individual) discounts for mail deliveries to those large customers (telecoms companies, banks) that undertook to use the mailing services of the Hungarian Post for their regular deliveries (typically customer receipts, invoices) and which also avail themselves of the separate printing service of the Hungarian Post.

(the latter being acceptable under Article 82 of the EC Treaty as well as under Article 21 of the HCA). Based on this distinction, the HCO divided the relevant discounts into three major categories in general:

- A) a volume discount that is solely based on the amount/volume purchased;
- B) a fidelity discount that is (i) not based on the specific volume [supplied to the customer], but rather on the requirements of the customer (or the significant portion thereof), and (ii) the discount is in exchange for the exclusivity for fulfilling that requirement (or a large part thereof); and
- C) a special case, where (i) the discount does correspond to a given volume, while in fact (ii) it is not based on volume, but rather on the assumption that the given volume represents the presumed take-on capacity of the customer. In this case therefore the discount is not based on the largest volume but rather the largest possible percentage of the demand [of the given customer].

The HCO found that discounts provided by a dominant undertaking falling under categories B) and C) above may well amount to abuses of a dominant position, while a discount falling under category A) above can be considered to be competition-neutral. In terms of the competitive nature of such discounts, the HCO put great emphasis on their possible exclusionary effects, and stated that they may infringe Article 21 (i) of the HCA (which prohibits the hindering of market entry without justification) as well as Article 21 (j) of the HCA (which prohibits the creation of an unduly detrimental situation for a competitor) (paras 45-47 of Vj-174/2005 (Magyar Posta)).

Finally, in a case relating alleged price discrimination by the incumbent telecommunications provider in 2006 - although the HCO did not use the term “fidelity discount/rebate” - it did accept that “*it is possible to achieve price discounts by ordering larger amounts. It is not against the HCA for a company to pass on such price reduction to its customers.*” (Vj-124/2003 (Axelero), para 52). The HCO then went on to examine the given differences in prices in more detail and found that “*the higher share from the price discount was indeed substantiated by considerations of economies of scale and [its application is] thus well-founded*” ((Vj-124/2003 (Axelero), para 52).

D) Conclusions

In the absence of a wide-ranging practice of the HCO analysing fidelity discounts, it is very difficult to provide a clear definition of such discounts on the basis of the case-law of the HCO. There is also virtually no judicial practice, either that would assist practitioners in finding a proper definition and thus a yardstick to evaluating practical issues. Nevertheless, as it has been made clear above, the HCO regularly (even in cases where it applies merely national competition law) makes references and bases its decisions on economic and legal considerations developed in EC law. Such a reliance on EC law is clearly justified, since the notions of Hungarian competition law on the abuse of a dominant position are materially identical to those under EC competition law.

Therefore it can be expected that the HCO's decision in a given case relating to fidelity rebates/discounts will largely follow the guidance provided by the European courts and the Commission. As the case-law on the EC level relating to such discounts is also not clearly settled and as the law is very much economics/effects-based, there is clearly further room for legal certainty in this respect.

2) Cost justification

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

Special rebates or discounts granted by dominant firms in return for securing all or an increased proportion of the business of their customers may infringe Section 21 of the Competition Act, the national equivalent of Article 82 EC, as such conduct may have an exclusionary effect by foreclosing the market to competitors.

Rebates or discounts are however not prohibited *per se* and an objective justification, in particular a cost justification, is generally accepted by the HCO. A cost justification may be invoked typically in two scenarios: first in connection with rebates conditional on the purchaser agreeing to certain terms and conditions that result in costs savings for the dominant seller (e.g. the electronic processing of orders), and second in connection with quantity rebates or discounts which are linked to costs savings resulting from larger purchases. If such rebates merely pass on the resulting benefits to customers, they are generally considered to be compatible with competition law.²

Nevertheless, the HCO only accepts quantity rebates which are based on *measurable* cost savings, and where the rebates are *proportional* to cost savings. Otherwise, if these conditions are not met, rebates may be considered unjustified and illegal.³ Cost justification is accepted, therefore, if it is based on savings resulting from economies of scale and there are actual cost savings resulting from larger sales volumes. It is not possible however to argue a cost justification in connection with rebates that aim to

² Vj-174/2005 Magyar Posta para 48.: " *the discounts corresponding to the sales conditions resulting cost saving for the Hungarian Post do not infringe either Article 82 of the EC Treaty, or Article 21 i) or j) of the HCA. Similarly, the discounts based on the turnover qualified as volume discount, mean actually the division of the advantage coming from the economies of scale of the larger order (cost saving) with the customer.*" Vj-1254/2003 Axelero para 52.: "...by larger orders discounts may be acquired. It does not violate the provisions of the HCA if an undertaking shares the economies of scale achieved this way with its customers."

³ Vj-87/2001 Matáv para 15.4.: "a so-called quantity discount provided by a dominant company – corresponding to the amount/quantity of the service [...] – can be regarded as legal if [such discounts] can be justified with objective reasons relating to economic of scale, that is if the higher volume of services ordered results in a demonstrable reduction of costs at the service provider. However, if there is no demonstrable cost saving related to the extent of the purchase, or the cost saving is not proportionate with the extent of the discount..., the provision of the discount is considered as unjustified, and thus it may entail a competition law infringement as well".

achieve economic tying (mixed bundling),⁴ or if an exclusionary intent (i.e. foreclosing the market from competitors) can be established.⁵

Moreover, a cost justification is only accepted if the rebate scheme does not discriminate among customers, and customers receive a reduction which corresponds to their contribution to cost savings.⁶ Larger customers may therefore receive larger rebates, however, a rebate scheme with particularly high thresholds designed to benefit only one or a few particularly large customers, may be considered unjustified and discriminatory.⁷

If rebates are not linked to fixed quantity thresholds, but rather to meeting or increasing the quantities purchased by the customer in a previous reference period, an exclusionary effect is more likely to be established. But even in such cases, the HCO will assess - in particular with regard to the amount of the rebate - whether the conduct is at least potentially capable of excluding competitors. The HCO found e.g. that a fidelity rebate of 1 - 1.5 % granted by the Hungarian Post conditional on its customers meeting their purchase volumes of the previous year did not amount to an abuse, as the fidelity rebate - in particular with regard to its low level - was not capable of foreclosing the market and to hinder market entry or exclude competitors.⁸

3) Price discrimination

“Fidelity” discounts are meant to compensate exclusive purchasing patterns. Therefore “fidelity” discounts are inherently discriminatory. A purchase of 100 units may trigger a discount if the supplier covers all the needs of the acquirer for that particular product, otherwise the acquirer may not receive any discount (and pay a higher price than its competitors). This implies that acquirers of the same quantities may face different prices.

3.1 In your jurisdiction may price discrimination by a dominant firm violate antitrust law? If so, how is this discrimination defined? In particular, is this discrimination

⁴ Vj-167/2001 Magyar Posta para 76.: *“According to the argumentation of the Hungarian Post, the discounts granted shall be qualified as volume discounts provided for the larger quantities, and thus they are absolutely justifiable. However, it could be established on the basis of the documentary evidence that the Hungarian Post granted larger discounts in a number of cases – even if not in every case – than usual, since the contractor also asked the Hungarian Post to prepare the given deliverable as well.”*

⁵ Vj-73/2001 Holcim para 111.: *“the price- and discount policy [of HCM] restricts market entry without justification if the dealer is entitled to the given discount if it undertakes not to purchase any competitive goods from the competitors or from certain competitors of the supplier (non-competition). In the present case, the behavior of HCM was expressly aimed at limiting the sales of the cement coming from abroad.”*

⁶ Vj-124/2003 Axelero para 53.

⁷ Vj-124/2003 Axelero paras 53-54.; Vj-87/2001 Matáv para 15.4.: *“...[if] only one or a few of the contractors is entitled to the discount because of the threshold limits of the discount bands or of the level of the discounts offered, this could be illegal from a competition law point-of-view as it discriminates against those clients of the service provider are only capable of putting smaller orders”*

⁸ Vj-174/2005 Magyar Posta para 52.: *“...in the absence of an exclusivity clause, the extent of the discount is of a great importance when examining whether a discount may restrain the market entry of other undertakings. The Fidelity discount being at the rate of 1% (or 1,5 % when realizing a very high turnover). the [HCO] did not find a violation of Article 82 of the EC Treaty or Article 21 i) or j) of the HCA “*

*prohibited per se or only inasmuch as it actually distorts competition in the market?
Please describe*

Similarly to Article 82 of the EC Treaty, the HCA also addresses the issue of discrimination: Article 21 (g) HCA condemns, as abusive “*the differentiation between trading parties without justification in case of deals having identical value or characteristics, including the application of such prices, payment terms, special sale or purchase conditions or methods, which place certain trading parties at a competitive disadvantage.*”

It is clear on the basis of the above definition that price discrimination - a term that economists use to describe the practice of selling the same product to different customers at different prices even though the cost of sale is the same to each of them – falls within the scope of abusive practices. Although the HCO’s case-law has not provided a full-fledged definition of price discrimination, it is clear that under the Hungarian rules, there are two conditions to be met for price discrimination: (i) to apply dissimilar prices to equivalent transactions, and (ii) the existence of a competitive disadvantage.

The evaluation of the former criterion is complex and fact-sensitive: it appears that applicable authorities lack coherence and do not provide a clear test on the basis of which the equivalence of transactions could be determined. As to the latter criterion, the existence of competitive disadvantage implies that the application of different prices should also distort competition among the partners of the dominant seller. In most cases, the European Commission almost automatically assumed that the given discrimination resulted in placing trading partners at a competitive disadvantage⁹, while the HCO, on the other hand, has, in number of cases, looked at this issue more closely.¹⁰

It is thus clear that the HCO’s practice does not consider price discrimination to be prohibited “per se”. To the contrary, the HCO expressly acknowledged that price discrimination may result in a given supplier providing services to more clients and thus may in general enhance consumer welfare (Vj-69/2005 (Hungarotel), para 63., Vj-39/2005 (Magyar Telekom), para 49). In a case relating to the Balaton port operator, the HCO generally emphasised that “undertakings have the right to use the tool of price discrimination in so far as such conduct does not cause such a disadvantage that could affect consumer welfare (as a result of a decrease in [overall] turnover)” (Vj-38/2005 (BHRT), para 62.) The HCO thus – either by way of the verification of the existence of competitive disadvantage or in a more general manner - undertakes to examine whether there was an actual distortion on the market as a result of the alleged price discrimination.

⁹ See most prominently T-229/94, *Deutsche Bahn v Commission*, para 78. See also T-128/98 *Aéroports de Paris v. Commission* and C-163/99 *Portugal v. Commission*.

¹⁰ See the decisions of the HCO in Vj-38/2005 (Balatoni Hajózási Rt.); Vj-14/2003 (Vidanet) Vj-83/2003 (Zalaegerszeg) or Vj-87/2001 (Matáv)

In most jurisdiction price discrimination may only be prohibited when put in place by a dominant firm, i.e. dominance being a necessary but not sufficient condition for a prohibition. However in some jurisdictions price discrimination may be prohibited also when put in place by non dominant firms.

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?

Apart from specific rules on pricing and the prohibition of discrimination related to special sectors (gas, electricity, water, etc), we are not aware of such rules.

It is important to note that there is a special regime for undertakings having “significant market power”, which also relates to price discrimination (Section 7 of Act CLXIV of 2005 on Commerce). Such power is defined not only with a view to the actual market power of the undertaking concerned (as defined on the relevant market), but also on the basis of a presumption based on a net sales revenues threshold to be reached by the given undertaking. Thus, even an undertaking with no or minimal actual market power (within the meaning of competition economics) may fall under the scope of the regime. Under the Act on Commerce, undertakings having such “significant market power” are prohibited to abuse such market power as against their suppliers: the examples of such an abuse contain the “differentiation between suppliers without justification”, which may thus include price discrimination. It is also the HCO that has the power to initiate proceedings against such undertakings; there were only a few cases closed for the time being (none of them related to price discrimination).

4) Exclusionary nature of “fidelity discounts”

Discounts can be exclusionary when they do not allow competitors to profitably compete with the discounting dominant firm. However there are a number of problems associated with this exclusion. The first one relates to the burden of proof. Is indirect evidence (e.g. the fact that competitors market shares were not affected) sufficient to rule out any exclusionary effect?

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

A) Burden of proof in relation to abusive practices in Hungarian competition law

Under the relevant Hungarian procedural rules, - similarly to the provisions of Article 2 of Regulation 1/2003/EC relation to the application of Articles 82 of the EC Treaty -, it is clear that the burden of proving an infringement under Article 21 (the prohibition of the abuse of a dominant position) rests on the party/authority alleging the infringement (that

is, in competitive proceedings, on the HCO) (see Vj-142/2005 (Invitel), para 32), Vj-77/2005 (Antenna Hungária), para 124).

In light of the HCO's case-law, however, it is much less clear as to what is the extent and nature of evidence that is necessary for the authority to prove an infringement, especially in cases relating to exclusionary conduct such as the use of rebates and discounts. In a seminal case relating to various rebates schemes applied by the Hungarian Post, the HCO stated that the decisive factor from the perspective of finding an infringement is whether the given conduct was "*capable of*" having a detrimental effect (on competitors) as well as unduly strengthening the position of the dominant company ("*suitability [or "per se"] test*"). The HCO – inter alia referring to the judgment of the Court of First Instance in T-203/01 (Michelin II) - expressly underlined that in order to find an abuse of a dominant position both under EC and Hungarian competition law, the examination of actual effects on the market is not necessary (para 57 of Vj-174/2005 (Magyar Posta)).

Similarly, in a decision relating to a telecommunications service provider giving discounts in order to hinder market access of competitors, the HCO underlined as a matter of principle that under Article 21 (i) of the HCA "*the hindering of market entry can be committed not only by actually preventing market access but also by substantially making it more difficult*" and that under Article 21 (j) of the HCA, "*it is not a precondition for finding an infringement under that point for the given competitor to be actually excluded from the market, rather it is sufficient if its market presence is substantially reduced (or is not increased to an extent that it would have increased in the absence of the given conduct)*" (para 30 of Vj-142/2005 (Invitel)). The HCO emphasised in that case that a careful analysis of the market nevertheless is necessary in case of so-called "indirect" methods of restriction of competition, such as the reduction of prices. The HCO finally reinforced the application of the "suitability test" and stated that "*the lessening of competition can only be established if the given conduct is capable of foreclosing the market, or at least it can be realistically expected that the company is able to sustain the market share acquired (retained) as a result of the given conduct (even after the termination of the given conduct)*" (para 32 of Vj-142/2005 (Invitel)).

Notwithstanding the above points of principle, - as will be detailed below - the HCO in most of the relevant cases put a great emphasis on analysing the actual situation before and after the introduction of the complained conduct to verify whether the given conduct had actual effects on the market ("effects test").

B) The use of evidence in exclusionary cases (the application of the various "tests")

The HCO in a case concerning certain tying practices (thus not fidelity rebates) expressly stated that "*in relation to the abuse, the [HCO] found it decisive whether the restriction of the access structures could have resulted in a substantive amendment of the market structure in favour of [the dominant undertaking]*" (para 140 of Vj-69/2005 (Hungarotel)) (thus applying the "suitability test"). Still, the HCO took care to use the "effects test" to come to a final conclusion in respect of the given practices: in relation to one type of conduct (certain rather high-priced telephone packages), the HCO found that

the undertaking's practice had the effect of foreclosing the market, which directly resulted in higher dialling fees for consumers. In contrast, in relation to another type of conduct ((the alleged restriction of wholesale dial-up Internet access)), after having analysed the market movements in detail (market entries and exits, market shares), the HCO concluded that in the given case – although the position of the given company has become stronger and some companies exited from the market – these market movements were not in causal connection with the alleged abusive conduct. Similarly, in an early case concerning certain discounts provided by the Hungarian Post, although the HCO started out from the “suitability test” (it noted that the conduct was “*capable of putting the competitors at a disadvantage of squeezing them out of [...] the market*” (para 80 of Vj-167/2001 (*Magyar Posta*))), it again ended up with the “effects test” and actually took into consideration that the given infringement in fact resulted in exclusivity and tying effects with certain customers.

In an important case initiated against the Hungarian telecommunications incumbent, the HCO again used both “tests” as described above and established certain points of principle regarding the relevance of the market situation (and the market shares of competitors) in the competitive evaluation of exclusionary practices (Vj-42/2006 (*Magyar Telekom*))¹¹. In its decision, the HCO explained at the outset that while certain exclusionary practices (in particular rebates and discounts) are obviously advantageous for the consumers on the short run, they may still result in long term disadvantages for such consumer as a result of the lessening of the competition of the given market (e.g. occurring as a consequence of the lessening of the number of market players). Thus, the question for any regulatory body in such a case is whether the taking away of the given (instant) advantage from the consumer is duly balanced by the fact that the consumers are likely to suffer a more serious harm later in the process. In order to assess whether such “more serious harm” is indeed likely to happen, the HCO accepted that the actual effect of the conduct on the market shares of competitors could clearly be a significant factor and the HCO went on to analyse any changes in the market shares in the relevant period.¹² The HCO nevertheless appeared to consider minor market changes to be neutral (or even positive) from the perspective of the consumer¹³ and stated that it would only be a drastic lessening of competition (eg the creation of a quasi-monopolistic situation or the disappearance of a given service provided only by the competitors of the incumbent) that would justify regulatory action. It is important to note, however, that the facts of the case were rather special: it related to a specific issue on an evolving telecommunications market, and the decision contained legal considerations relating to a possible abuse even though the dominant position of the company under investigation was not established.

¹¹ The given decision did not strictly concern a “fidelity discount”, in fact, it related to the provision of “free of charge” landline calls in certain periods of certain days by a possibly dominant company.

¹² In the given case, the HCO took note of the fact that even though in theory the complained practice (the provision of free of charge landline calls) may have the effect of restricting other competitors, in fact such effect cannot be demonstrated on the basis of the relevant market data (there was actually no measurable change in the relevant shares of the competitors after the introduction of the given discounted service).

¹³ The HCO stated that even if it could be proven that the competitors would have had higher market shares in the absence of the complained practice, this in itself could not entail competition problems as this would merely have “strengthened the push for efficiency by its competitors”.

C) Conclusion

Although in theory the HCO uses the “suitability test” to identify abusive conduct (ie to check whether a given conduct is “capable of” having a detrimental effect on competitors/competition), the HCO in practice clearly takes into account any actual effects when establishing the possible anti-competitive nature of a given conduct (“effects test”). The practice of the HCO therefore requires a relatively high burden of proof to find for an infringement, especially as some of the HCO’s decisions appear to suggest that even if certain effects can indeed be identified on the market, such minor or less drastic effects in themselves are still insufficient for finding an infringement. In addition, the HCO in some cases also – quite rightly - verified whether any negative effects on the market in the relevant period were indeed in a causal connection with the alleged abusive conduct. Thus - although the relevant decisions are not entirely clear in this respect – indirect evidence showing that the market shares of competitors (or complainants) were actually not affected (or only affected to a minor extent) is likely to mean the HCO will find against the given infringement.

In order to assess whether a fidelity discounts strategy is actually exclusionary, competition authorities may need to assess whether the practice is replicable by competitors. Replicability depends on whether matching the pricing strategy of the dominant firm would lead competitors to price below some measure of costs. Therefore, it is necessary to assess whether, as a result of discounts, prices fall below some measure of costs (average variable, average total, incremental or marginal). Furthermore, as for predatory prices, the assessment could be made over the cost of the dominant firm, or, alternatively, over the relevant costs of 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?

We refer to our response below at 4.3.

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

A comparison of costs and revenues is necessarily carried out in the assessment of predatory pricing cases. According to settled case-law, the HCO must prove the following three conditions in order to establish the existence of predatory pricing: i) the dominant company applies below-cost pricing, ii) it has the necessary economic power to take losses resulting from below-cost pricing, and iii) there are barriers to entry which make it possible for the dominant company to recoup losses by increasing prices above the competitive level after having driven competitors out of the market.¹⁴

¹⁴ Vj-44/2003 UPC para 148.; Vj-159/2003 MOL, OTP, MATÁV, FOTEX para 46.; Vj-138/2003 ISOPLUS para 56.

In applying the above test in practice, the HCO broadly follows the principles set out by the case-law of the Community courts.¹⁵ Pricing is therefore presumed to be predatory if price is below average variable cost (AVC), while it is excluded if the price exceeds average total costs (ATC). If prices are between AVC and ATC, predatory pricing can only be established, if the HCO can furnish proof of a strategy aimed at eliminating competition (or that the conduct has no other rational economic purpose).¹⁶

While in order to establish predatory pricing, prices must go below some relevant measure of cost, fidelity rebates may be considered illegal even if the price exceeds all levels of cost. The competition concern in case of fidelity rebates does not result namely from the fact that the price is too low (e.g. below-cost), but from the fact that the lower price is conditional on the customer meeting certain (anticompetitive) conditions. While in case of predatory pricing, the lower price is granted unconditionally to customers, in case of fidelity rebates, a lower price is granted only if the customer's purchases meet a specified quantity or another threshold such as a certain increase relative to a past period. If the threshold is set to cover the customer's whole demand (or a major part of it), the rebate may function in practice as a *de facto* non-compete obligation capable of foreclosing the market to competitors.

Fidelity rebates are, however only considered illegal if they are capable of achieving an exclusionary effect, i.e. if as a result of such conduct "as efficient competitors" can not compete for the demand for which customers would consider switching in the absence of the fidelity rebate scheme. Although the HCO has not yet elaborated the details of the "as efficient competitor" test (see our analysis as to the uncertainty of the current case-law at 4.1. above on the "suitability" and the "effects" tests), it is likely to follow the EC case-law and the guidance set out in the Commission's Art. 82 discussion paper.¹⁷ Accordingly, a rebate scheme would most likely be considered problematic, if it hinders as efficient competitors from supplying commercially viable amounts to customers.

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

As discussed above, the HCO would most likely adopt an "as efficient competitor" test, whereby the costs of the dominant firm are taken as a benchmark for the purposes of any comparison. This results from the fact that the purpose of competition law is not to protect less efficient competitors, but to protect competition by ensuring that efficient competitors are not excluded from the market by less efficient dominant companies to the detriment of consumers.

¹⁵ See e.g. Case C-333/94 *Tetra Pak v Commission* [1996] ECR I-5951, para 41 summarizing the "AKZO rule".

¹⁶ Vj-168/2004 *Auchan & Tesco* paras 19-21.

¹⁷ DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses; Brussels, December 2005; available at: ec.europa.eu/comm/competition/antitrust/art82/discpaper2005.pdf

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*

Although the HCO has not yet decided on the above issues, it is likely to follow the EC case-law and the guidance provided in the Commission's Art. 82 discussion paper.

5) Justifications for exclusionary discounting policy

Appropriate consideration might be given to the fact that in a pluralistic market structure (where the number of competitors is greater than two), expansion or new entry is limited by rivalry from all market participants, not just from the dominant firm. In this respect, the record of entry in the industry and the relative movements of market share from year to year should be given proper consideration, in the sense that if there is profitable and extensive entry in the industry in the course of the years practice was in place, the practice itself may not be as exclusionary as expected.

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 a 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.*

The HCO clearly accepted in a number of cases that the primary (objective) justification for discounts can be cost reductions achieved as a result of larger orders (economies of scale and scope) (see in detail at 2, above).

In relation to price discrimination practices, the HCO clearly stated in a case that in light of the relevant EC jurisprudence¹⁸ that it is possible to justify price discrimination between two customers with clear reasons relating to economies of scale and scope (Vj-124/2006 (Axelero), para 53.). In another case, the requirements of transparency and non-discrimination was also added to the necessary conditions for justification (Vj-167/2001 (Magyar Posta), para 87. These justifications would thus have a high probability to be accepted by the HCO.

The issue whether other justifications - such as profitable and extensive entry in the industry in the course of the years the practice was in place - could prove to be sufficient in order to find against an infringement in relation to exclusionary practices has not been discussed extensively in the HCO's relevant decisions. Nevertheless, in light of the considerations set out in 4.1. above (namely, that the HCO in practice almost always verifies if the given practice had an effect on the market), it is likely that the HCO would be receptive to such justifications raised by a dominant company. This is even more so if the "degree" of dominance in the given case is not exceedingly high (that is if the given

¹⁸ In particular, the so-called Spanish, Portuguese, Belgian airports decisions of the European Commission.

firm is not in a monopolistic or super-dominant position) or if the market is a clearly evolving and fast moving one (eg a technology market).

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?

We are not aware of any such issues.

6.2 Any concluding remarks?

N/A