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Modernisation of Article 82: Use of Economic Analysis for Rebate Systems

The process of modernisation has reached Article 82 EC Treaty. Recently, the European Commission published a discussion paper on these changes (<http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf> and CCR 15). The discussion paper deals with issues on exclusionary conduct. The focus of this CCR is on a special mode of exclusionary conduct namely rebate systems.

Rebate Systems in the EC Commission's Discussion Paper

In coherence with the overall modernisation process, the economic effects of rebate systems need to be analysed more thoroughly in the future. The antitrust concern is to prevent exclusionary conduct of a dominant firm. Within the discussion paper, a basic distinction for rebates is drawn between unconditional and conditional rebates. Unconditional rebates, while granted to certain customers and not to others, are granted for every purchase of these particular customers, independently of their purchasing behaviour. On the other hand, conditional rebates are granted to customers to reward a (certain) purchasing behaviour of these customers.

The main possible negative effect of rebate systems is market foreclosure of actual and potential competitors. Thus, the purpose of Article 82 is to ensure that competitors are able to expand in or enter the market and compete therein on the merits, without facing competition conditions which are distorted or impaired by the dominant firm. Foreclosure effects are more likely if rebates are granted unconditional and selectively. In particular the European Commission considers the occurrence of foreclosure as likely, if

- The dominant company applies a conditional rebate system where the rebates are granted on all purchases in a particular period once a certain threshold is exceeded, and
- there is no indication that this threshold is set so low that for a good part of the dominant company's buyers it can not hinder them to switch to and purchase substantial additional amounts from other suppliers without losing the rebate, and
- the required share exceeds the commercially viable amount per customer, and
- the dominant company applies the rebate system to a good part of its buyers and this system therefore affects at least a substantial part of market demand, and
- there are no clear indications of a lack of foreclosure effect such as aggressive and significant entry and/or expansion by competitors and/or switching of customers.

Consequences Disregarding Article 82

Article 82 may be applied to a rebate system if a firm's market share exceeds 40%. Thus, it is essential for companies with high market shares that their rebate systems are in accordance with the legal requirements. Non-compliance can lead to significant fines. In March 2006, the European Commission has imposed a fine of € 24 million on Norwegian group Tomra for violating EC Treaty competition rules on the abuse of a dominant position. The Commission has found that Tomra abused its dominant position on the market for the supply of machines, usually installed in retail outlets, for the collection of used drink containers in return for a deposit, in Austria, Germany, the Netherlands, Norway and Sweden. The Commission concluded that Tomra's practices, consisting of i.a. loyalty-inducing discounts restricted or at least delayed the market entry of other manufacturers. This constitutes a serious abuse of its dominant position. Competition Commissioner Neelie Kroes commented on this decision: "I will not tolerate dominant companies hindering competition or excluding other players from the market, as this harms innovation and consumers. Rebates and discounts cannot be used by a dominant company as part of a strategy to exclude actual and potential competitors." (See Commission's press release)

Thus, companies with high market shares need to assess whether their rebate systems are coherent with the new modernized approach. A thorough economic assessment is required to judge on whether the rebate systems are legally compliant. Such an analysis is a challenge for every company but at the same time, it creates opportunities too.

Relevance of Rebates

For manufacturers, rebate systems are an important tool to boost sales by providing incentives to buyers. Buyers benefit from rebates by lower prices. On the other hand, unbalanced rebate systems may damage the positioning of a product. However, because of the importance of rebate systems for sales figures, a give-up of rebates is not an economically feasible strategy: the abandonment of a rebate system can ultimately lead to a weakening of the market position. A give-up would also be problematic for consumer welfare reasons: The fact that rebates can be welfare enhancing is an argument in favour of price cuts by means of rebates. In this context, it is crucial that the rebates are given without discrimination and are no harmful to competition. The burden of proof is on the dominant company. An economic analysis can generate legal certainty by exploiting at the same time the positive effects of rebates.

Possible Solutions: A Performance-based Rebate System

Especially firms with high market shares need to pay close attention to the legal compliance of their rebate systems. The key for a successful rebate system which complies with Article 82 lies in the economic justification of the rebates: firms granting rebates need to receive a "service" in return for their rebates. In addition by applying economically rational strategies, producers are well advised to exploit the potential of influencing retailers' behaviour by means of a proper rebate system. The give-up of simple quantity rebates bears many promising opportunities: a performance-based rebate system facilitates the successful realisation of strategic goals e.g. on brand policies by conditioning rebates e.g. on improved product presentations or on an increase in promotional activities.

In such a system, unconditional rebates do not occur. In correspondence with the "more economics based approach" or "effects-based" approach, the impact of the rebate system on competition is the decisive criterion. It should be noted that the respective economic effects of rebate systems need to be assessed individually and may diverge case by case.

The sorting out of complex and intricate rebates is a crucial requirement to achieve legal certainty. To accomplish this goal, EE&MC has developed a rebate system which is presented in the following.

EE&MC Rebate System

One way of implementing a modern and flexible rebate system is to let retailers “earn” rebate points as reward for certain behaviours in favour for the rebate granting firm. The rebates are conditioned to the fact that they generate an economic benefit to the producer. EE&MC has applied this approach by developing a modern rebate-point system for a leading producer of branded goods which complies with the requirements of Article 82. The economic effects of the rebate-point system are simulated in a rebate model which is accessible to both, the producer and trader/retailers. The following rebates are examples of such feasible rebates:

➤ Presentation Rebates

Rebates are conditioned on the favourable presentation of the manufacturers’ products in retail outlets: retailers can earn rebate points for an increase in the shelf space of the relevant product, the implementation of the manufacturers’ shelf vision, or a separation from private labels.

➤ Distribution Rebates

Examples of rebates related to distribution issues are rewards for a faster listing of new product innovations or for an increase in the distribution of the products within a retailer’s outlet.

➤ Promotion Rebates

Rebates related to promotions may be conditioned on the share in promotions.

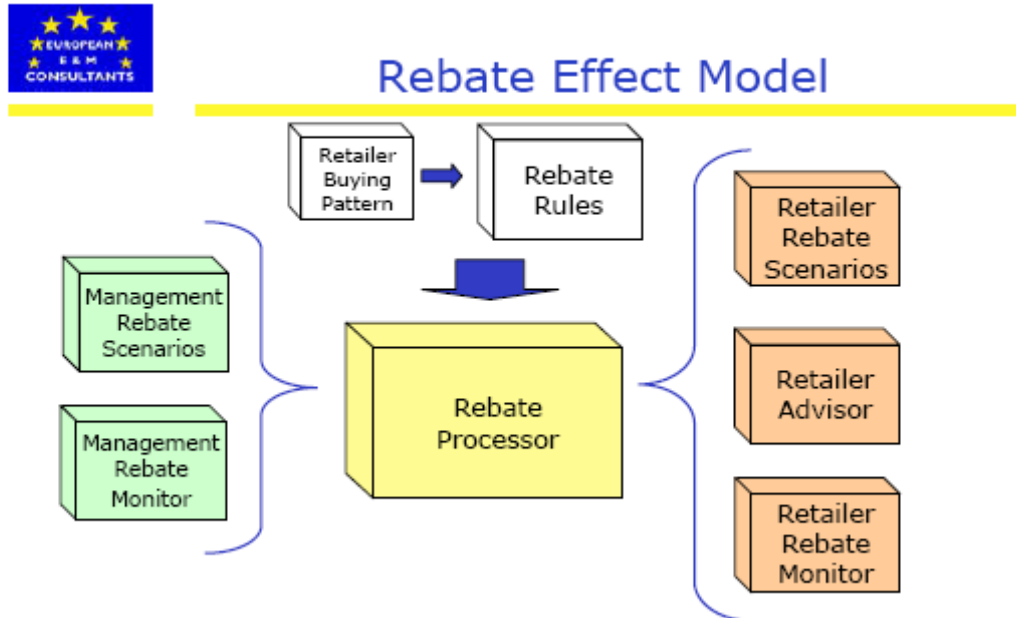
➤ Logistics Rebates

Rebates related to logistics may have a significant impact on a producer’s efficiency. Examples for such rebates are rebates conditional on the payment or ordering behaviour of retailers, for example, ordering full trucks or eliminating inter-company transports.

In such a rebate-point system, rebates are assigned to one of the four groups illustrated above: presentation, distribution, promotion, and logistics. In a first step, retailers can earn rebate points if they fulfil certain, pre-defined and transparent behavioural criteria. In a second step, rebate points are weighed according to the strategic importance the producer assigns to this particular rebate/behaviour. Finally, the sum of the weighed rebate points is allocated to a percentage rebate.

The producer can simulate the effects of the rebates in the EE&MC rebate model (see graph below).

Graph 1: EE&MC Rebate Model



Based on the actual buying pattern, retailers' performances with relation to the rebate criteria ("Rebate Rules") are simulated. The results of the pre-defined rebate rules are illustrated in the rebate processor. Within the rebate processor, both rebate points and the percentage of the rebates are evaluated. The results are shown in the "management rebate monitor" to the producer indicating the rebate retailers would earn for their actual behaviour. The producer can change the rebate rules and also simulate various "what-if" scenarios on hypothetical retailer behaviour in the "management rebate scenarios". The results of these scenarios are again shown in the "management rebate monitor". Retailers, too, can monitor the effects of their actual and/or hypothetical behaviour ("retailer rebate scenarios"). The actual rebate is shown in the "retailer rebate monitor". However, retailers cannot change the rebate rules and do not have access to the rebates of other retailers. On request, the "retailer advisor" proposes recommendations how to adjust the retailer's behaviour such as to maximise rebates.

Economic tools like the EE&MC rebate system combined with the rebate model are really helpful for undertakings: such a rebate-point system assures legal certainty and at the same time realises the full potential rebates may generate for producers and retailers.

To sum up, undertakings can profit from the reforms of European competition policy. The reassignment and reorganisation of rebates produce

considerable gains: rebates are now conditioned on economic performance criteria. The abolishment of unconditional quantity rebates by implementing a performance-based rebate system provides the possibility to accomplish strategic brand objectives to the benefit of all stakeholders including consumers. On the other hand, the economy does not suffer anymore from a competitive harmful rebate systems.

Thus, the actual changes in EU competition policy are full of many opportunities.

EE&MC Approach

The EE&MC approach starts with a preliminary assessment of a company's existing rebate system. The evaluation whether the different rebates comply with the "more economics based approach" in EC competition law gives a first important indication. EE&MC possesses broad experiences with such analyses as well as with the empirical evaluation of exclusionary conducts. If some of the rebates are prohibited under Article 82 or are at least problematic, EE&MC develops in a second step an individual rebate-point system which is legally compliant and supports the company's strategic goals. In a third step, rebate systems like the rebate model described above are implemented.