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The Unilateral Conduct Working Group: You Be the Judge— Scrutinizing a Loyalty Discount & Rebate Case

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Pricing has never been more complex for companies operating across national borders. In addition to considerations arising from local supply and demand conditions and factors such as national tax laws and exchange rates, companies operating internationally must also take into account the potential effects that different countries' competition laws may have on their pricing practices. And over the past two decades, competition laws have proliferated to more than one hundred countries around the world, from micro-states such as Jersey and the Faroe Islands to rising economic superpowers such as Brazil, India and China.

The competition laws in virtually all of these countries potentially apply to the unilateral pricing conduct of firms found to have a dominant position. The standards for judging pricing conduct—such as loyalty or bundled discounts, predatory pricing, excessive pricing, margin or price squeezes, and discriminatory pricing—differ across jurisdictions, sometimes substantially. Even standards within individual jurisdictions can be unsettled or in a state of transition. Likely in no other area of competition law are standards so unsettled.

One of the reasons for the widely differing views on a dominant firm's pricing conduct is that pro-competitive and anticompetitive behavior often look the same—conduct that may be efficiency enhancing may look the same as conduct that excludes potential entry and forecloses rivals. Virtually all antitrust practitioners would agree that conduct such as competitors agreeing to set prices or divide markets is harmful to consumer welfare and thus must be prohibited. But what about a dominant firm providing discounts or rebates on the sale of its products or services? Consumers and customers, of course, benefit from reduced prices, which are exactly the type of behavior one would expect to see in a competitive market.² However, can a dominant firm's prices be too low—even if not necessarily below its own costs—in a way that results in harm to competition? In such circumstances, how is competitive harm measured?

These types of difficult questions involving a dominant firm's discounting practices were recently analyzed by members of the Unilateral Conduct Working Group (“UCWG”) at the 10th Annual Conference of the International Competition Network (“ICN”) in The Hague, Netherlands in May 2011. They were analyzed through the use of a hypothetical abuse of dominance case concerning a company called “Cerveja.” In this hypothetical, Cerveja has long been the largest supplier of beer in a country called “ICNland,” with a market share above 70 percent over the past several years and annual sales of approximately \$1 billion. It now faces

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² See, e.g., *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (“[C]utting prices in order to increase business often is the very essence of competition.”).

increased competition from “Hollandia,” a major international supplier of beer with global annual sales of over \$10 billion. Hollandia entered the supply of beer within ICNland through the acquisition of a local supplier, and grew its national market share from 13 percent to 18 percent in its first full year of operation. In addition to Cerveja and Hollandia, many smaller regional brewers also sell beer in ICNland.

In response to increased competition, Cerveja introduced retailer discounts called the “So Hoppy Together Program.” Under this program, Cerveja paid retailers quarterly and annual rebates based on the volume of Cerveja-brand beer sold during the period. To qualify, retailers had to at least maintain their existing volume sales of Cerveja-brand beer, and could qualify for greater rebates based on increased volume sales. The evidence provided with the hypothetical showed that the discount levels still left prices above Cerveja’s total costs, when measured over its entire annual production volume, and retail prices for beer decreased during the period of alleged abuse. Documents provided with the hypothetical, however, demonstrated an intent by Cerveja to maintain and gain market share through the discount program in the face of increased competition from Hollandia. In addition, Cerveja’s discounted prices were below the total costs of many of the smaller competitors, potentially undermining their longer-term viability.

After considering this hypothetical case in smaller break-out groups, the UCWG held a mock agency hearing before the plenary session of the ICN’s 10th Annual Conference. A case-team argued the case for abuse and a “devil’s advocate” panel³ argued the case for the defense, before both a two-judge panel and a “jury” consisting of the audience, comprising nearly 500 ICN delegates from roughly 90 countries. The case team argued that the So Hoppy Together Program was an abuse of dominance, based on: (i) Cerveja’s intent to exclude competition as expressed in its internal documents; (ii) structural effects such as increasing barriers to entry and expansion; and (iii) that the discounts were below Cerveja’s cost when attributed to the contestable share of the relevant market. The devil’s advocate panel argued that Cerveja’s discounted prices were not an abuse of dominance because: (i) they remained above Cerveja’s average total cost and thus could not foreclose an equally efficient competitor; (ii) there was no cogent and convincing evidence of consumer harm because retail prices decreased during the period of the alleged abuse; (iii) there was no foreclosure effect because Hollandia’s national market share increased; and (iv) that Cerveja’s intent to compete aggressively through discounts should be viewed as pro-competitive.⁴

At the conclusion of the arguments, and perhaps understandably given the unsettled nature of competition law and unilateral pricing conduct, there was a split decision. The mock judge panel agreed with the case team’s arguments concluding that the conduct was an abuse of dominance. However, equipped with hand-held voting devices, the ICN’s membership in the audience voted by a margin of 56 percent to 44 percent that there was no abuse and the case should be closed.

³ This term refers to a team within an agency used to test the strength of a case.

⁴ This hypothetical was also considered at a Workshop held by the UCWG in Brussels, Belgium in December 2010, attended by over 150 participants from more than 50 ICN jurisdictions. The importance of articulating a convincing story of harm to competition and consumers was stressed at the workshop. A copy of this hypothetical case and workshop materials are *available at* <http://internationalcompetitionnetwork.org/working-groups/current/unilateral/workshops-teleseminars/upcoming.aspx>

The differing outcomes between the judges and jury reflect the difficult challenges remaining for the UCWG in building greater convergence among different jurisdictions in the analysis of loyalty discounts and rebates. However, the simple fact that challenges exist does not mean that they are insurmountable, as the UCWG's 2009 *Report on Loyalty Discounts and Rebates* showed a reasonable degree of consensus on the central aspects of the analysis of such conduct.

In that *Report* several agencies indicated that loyalty discounts and rebates are considered a legitimate form of price competition and are generally pro-competitive. But, when employed by dominant firms, they have the potential to cause anticompetitive harm in certain circumstances. Given the potential benefits to consumers through lower prices, however, several responses expressed a cautious approach to enforcement.⁵ Many agencies said this cautious approach was necessary because loyalty discounts and rebates were common forms of business practice within their jurisdictions, and low prices in general are a hallmark of competition.

As with the ICN more generally, the primary objective of the UCWG is to promote convergence towards sound analysis and enforcement with respect to the application of competition law to unilateral conduct. The UCWG has taken several steps to promote convergence.⁶ Most notably, the Working Group developed Recommended Practices (ICN Recommended Practices) to assist agencies with the assessment of dominance and substantial market power.⁷

The ICN Recommended Practices recognize that the concept of dominance or substantial market power limits the scope of application of most unilateral conduct laws. Making dominance or substantial market power a prerequisite serves as a filter for intervention against specific anticompetitive conduct.⁸ The ICN Recommended Practices instruct that a firm should not be found to possess dominance/substantial market power without a comprehensive consideration of factors that affect competitive conditions in the market under investigation. The analysis of dominance/substantial market power includes, but does not stop with, the assessment of market shares. At a minimum, conditions of entry and expansion (affecting the durability of market power) also should be assessed.⁹ In addition, according to the ICN Recommended Practices, agencies should, where appropriate, take into account factors such as buyer power, economies of scale and scope, network effects, and vertical integration in a dominance assessment.

The Working Group analyzed specific types of unilateral conduct and prepared comparative reports on exclusive dealing (2008), predatory pricing (2008), tying and bundled discounting (2009), loyalty discounts and rebates (2009), and refusal to deal with a rival and margin squeeze (2010).¹⁰ These reports are useful not only to explain what individual ICN

⁵ ICN Report on the Analysis of Loyalty Discounts and Rebates Under Unilateral Conduct Laws (2009), available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc357.pdf>.

⁶ ICN Report on the Objectives of Unilateral Conduct Laws, Assessment of Dominance/Substantial Market Power, and State-Created Monopolies (2007), available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc353.pdf> ("ICN Objectives Report").

⁷ ICN Recommended Practices on the Analysis of Dominance / Substantial Market Power under Unilateral Conduct Laws, available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc317.pdf>. These Recommended Practices were adopted at the ICN's annual conference in 2008.

⁸ See also ICN Objectives Report, *supra* note 5.

⁹ ICN Recommended Practices I.2, *supra* note 6.

¹⁰ The Working Group gathered information through a questionnaire on agencies' approaches to assessing the conduct and the criteria used to distinguish pro-competitive from anticompetitive conduct. The Working Group

members are doing, but also create a broader framework for discussion over time to reduce uncertainty and provide a better understanding about how to deal with such conduct.

After studying how agencies assess single firm conduct in practice, the Working Group began drafting a Unilateral Conduct Workbook. The Workbook provides a definitional framework and common understanding of terms—dominance, market power, and market definition. The first chapter drafted covers the methods used to define relevant markets and to assess the existence of dominance, as well as the data and other evidence that might be useful to obtain in performing these investigational steps. The chapter was adopted at the 10th Annual Conference. The Working Group will decide shortly on next topics to address—with predatory pricing a likely candidate. Future chapters on forms of conduct will build up the catalog of work to which ICN members can turn.

The next stage is to try to agree on common principles and approaches to particular practices. The Working Group anticipates that the process of developing and drafting the Workbook will lead to identifying further areas in which it could productively develop additional recommended practices or other guidance.

However, the UCWG recognizes that different views may make achieving consensus in some areas difficult. But even in these areas, and perhaps mostly in these areas, the ICN provides a valuable forum to discuss different viewpoints and share enforcement experiences. The Working Group held webinars on excessive pricing and discriminatory pricing—two areas in which there is a significant degree of divergence as to whether and when the conduct violates competition laws. The webinars stimulated a discussion on exploitative abuses and highlighted differences among member agencies' laws, policies, and viewpoints. Participants came away with a better understanding of the issues, of alternative ways of approaching the issues, and perhaps some further questions and ideas regarding members' own policies in these areas.¹¹

In summary, therefore, while pricing in different countries will always be a complex exercise for firms, the UCWG will continue to strive for sound enforcement and, where possible, increased convergence in the application of competition laws to unilateral conduct.

summarized the responses received from agencies, as well as responses from Non-governmental Advisors, covering between 35 and 45 jurisdictions. The questionnaires, responses, and reports are available on the ICN website at <http://www.internationalcompetitionnetwork.org/working-groups/current/unilateral.aspx>.

¹¹ For further discussion see Lagdameo & Heimert, *The Unilateral Conduct Working Group in The International Competition Network*, THE INTERNATIONAL COMPETITION NETWORK AT TEN, (Lugard, ed.) (2011).