



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

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**ROUNDTABLE ON RESALE BELOW COST LAWS AND REGULATIONS**

**-- Note by Germany --**

*This note is submitted by the German Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 19-20 October 2005.*

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## 1. Resale Below Cost law in Germany

### 1.1 Current RBC law and legislative rationale

1. In Germany, the specific resale below cost (RBC) law is included in the general competition law, the Act Against Restraints of Competition (ARC). However, it is less specific than RBC laws and regulations in some other countries as it covers all types of products and retail settings. Section 20 (4) ARC states:

*Undertakings with superior market power in relation to small and medium-sized competitors shall not use their market power directly or indirectly to hinder such competitors in an unfair manner. An unfair hindrance within the meaning of sentence 1 exists in particular if an undertaking offers goods or services not merely occasionally below its cost price, unless there is an objective justification for this.*

2. For a better understanding of the objective of Section 20 (4) ARC, it is useful to take a look at its context within the ARC and the EC Treaty, especially as far as predatory pricing is concerned. Predatory pricing is prohibited in accordance with Article 82 ECTreaty and Sections 19 and 20 ARC. The legal concepts under the ECTreaty and the ARC are quite similar, but looking at the conceptual details some differences can be identified. One main difference is that under Sections 19 and 20 ARC, the ban on predatory pricing applies not only to dominant undertakings, but also to undertakings with considerable market power below the dominance threshold. A second main difference is that the European Court of Justice (ECJ) has established a per-se rule that prices below average variable costs (AVC) are regarded as abusive under Article 82 ECTreaty. The caselaw on Sections 19 and 20 ARC has not established a per-se rule similar to the case law of the ECJ. Hindering other competitors as such is not sufficient to establish predatory pricing. Instead, the decisive criterion is whether there is an “objective justification” for the pricing behaviour, which allows a highly differentiated approach towards predatory pricing.

3. One could say that Section 20 (4) 2 ARC is the German counterpart of the per-se rule against below-AVC-pricing under Article 82 ECTreaty. However, the scope of Section 20 (4) 2 ARC only covers reselling activities. It states the legal presumption that if an undertaking offers goods or services below its cost price (German: “*Einstandspreis*”), such a conduct typically constitutes an unfair hindrance. The cost price is basically defined as the variable cost at which the reseller has purchased or is purchasing the goods or services concerned from its supplier.

4. The RBC-test according to Section 20 (4) 2 ARC breaks down into four main analytical steps:

1. *Superior market power*: The provision is targeted only at companies that have superior market power over small and medium-sized competitors in the same relevant product and geographic markets.
2. *Not merely occasionally*: Only offers at below-cost price that are made on a permanent basis come under the scope of the prohibition. One-off sales offers, such as advertising campaigns which have a short-term character, e.g. introductory offers, when a business opens, or sporadic special offers or lost-leaders, do not fulfil the conditions for prohibition. In the opinion of the Bundeskartellamt, offers which run for a minimum of three weeks can no longer be classified as “merely occasional” advertisement offers.
3. *Below cost price* (details see below).
4. *Objective justification* (details see below)

5. The legal presumption of Section 20 (4) 2 ARC was introduced with the 6<sup>th</sup> amendment to the ARC in 1998. Even though predatory below-cost pricing strategies could already be banned by using the ARC's instruments, the legislator opined that it was preferable to add a specific RBC provision. The main reason for this was to heighten the clarity of the legal limits of below-cost resales. The legislator wanted to draw the line on admissible pricing policy where intentional predatory practices or systematic below-cost resale jeopardise effective competition in the markets concerned. During the 7<sup>th</sup> amendment to the ARC in 2005, it was discussed to amend Section 20 (4) 2 ARC, especially with regard to the criterion "*not merely occasionally*". This discussion was prompted by continuing industry complaints about predatory pricing practices in the retail sector. However, the government opined that the interpretation of this criterion by the Bundeskartellamt gave no reason to amend the provision. Section 20 (4) 2 ARC thus remained unchanged.

## **1.2 Determination of RBC prices**

6. The Bundeskartellamt interprets the cost measure under Section 20 (4) 2 ARC basically as the variable cost at which the reseller has purchased or is purchasing the goods or services concerned from its supplier. This matches with the economic insight that sales below variable cost lead to short-term losses for the reseller, which would normally be irrational in the absence of long-term recoupment through lessening of competition.<sup>1</sup>

7. As compared to other predatory pricing cases it is quite simple and straight-forward to determine the cost price. This is due to the fact that generally there is no need to review the cost accounting of either the supplier or the reseller, so that the intricate question of cost allocation does not come up. Instead, it is usually sufficient to review the supply contracts.

8. The Bundeskartellamt takes the supplier's list price when determining the cost price of a good. All the price-affecting terms that have their basis in the procurement contracts are then deducted from this. Consequently, the cost price is not identical with the price charged for a specific individual delivery (invoice price), which contains only the directly calculable reductions (cash discounts, rebates, etc.). All other conditions (such as annual bonuses, advertising subsidies, sales promotion payments, total sales discounts etc.) are deducted in accordance with the respective item's share. An annual bonus, for example, is considered as a rebate on the annual turnover and deducted from the invoice price of the respective good at the respective percentage rate.

9. When a supplier conditionally agrees to grant a retailer a discount at the end of the contractual or purchasing period, the discount is included in the cost price provided that, when the retailer sets his prices to the final consumers, it is sufficiently likely he will actually be granted the discount, i.e. he is able to adapt his prices on the basis of this expectation. Any discounts which are unexpected or uncertain for the reseller are not included in the cost price.

10. The cost price does not include suppliers' payments which are only transitory items for the reseller and which are made in return for specific services provided by third parties (newspaper advertising, haulage firm services, etc.). Pro rata overhead costs of procurement are also not included in the calculation of the cost price. On the other hand, the cost price does include the ancillary costs of procurement that can be directly allocated to the specific delivery of goods (packaging, transport, freight, insurance, etc.) provided they are borne by the reseller. Goods are considered to be offered below cost price if the cost price that is established in the above manner is higher than the offer price of the respective product.

### **1.3 Business justifications**

11. Even if an undertaking with superior market power offers goods or services not merely occasionally below its cost price, this may be objectively justified. When examining whether a case is objectively justifiable, a comprehensive evaluation must be undertaken which takes account of the interests of the companies concerned while considering the objective of the ARC which aims at freedom of competition. An objective justification can thus generally be ruled out if predatory intent exists and competitive market structures are permanently threatened.

12. Economic emergency situations can primarily be considered as an objective justification. This may involve emergency sales of goods that are perishable, either physically, technically or due to changes in fashion, but also sales resulting from the threat of a business going bankrupt or closing down (as long as such offers last for more than three weeks at all). A company's new entry into a market, but not a mere change of ownership, can also constitute an objective justification.

13. Matching a competitor's (low) prices cannot per se be considered as an objective justification. An objective justification can be almost completely ruled out if the competitive prices are illegal below-cost prices set by other companies with superior market power. Otherwise the restraining effect to the detriment of small and medium-sized competitors would increase even further. In the (more or less theoretical) cases where the prices of a company with superior market power are undercut by (legitimate) below-cost prices of small and medium-sized competitors the objective justification has to be examined in each individual case.

14. Finally an objective justification can be considered if the cost price increases unexpectedly and exceeds the previous offer price. In this case the offer is as a rule only justified for a short period of time until a new supply source is established.

### **1.4 Compliance of RBC law with general competition policy principles**

15. As noted in the "scoping paper" for this roundtable,<sup>2</sup> ill-drafted RBC laws may have anti-competitive effects. It is therefore of great importance that RBC laws rely on the sound economic principles of general competition policy. Jurisdictions might not even find it necessary to enact specific RBC laws, but rely instead on the general ban on predatory pricing. Where a need for a specific RBC law is perceived, the substantive standards of RBC laws should include the same elements that are typically found in predatory pricing standards. The most important elements in this respect are (i) a sound cost standard, (ii) an assessment of market power, (iii) the possibility of an objective justification of below-cost resales for those cases where such conduct is not anti-competitive, but rather economically rational and efficient, including an assessment of predatory intent or effect (recoupment plausibility). As can be seen in the sections above, the German RBC law complies with these standards.

## **2. Enforcement of RBC law**

### **2.1 Public and private enforcement**

16. Beyond the proper drafting of RBC laws, it is of similar importance how the RBC law is enforced, because normally the law will state general, abstract principles which need to be concretised by the enforcement authorities and the courts. This is especially true for RBC laws as it is typically not easy to draw the line between pro-competitive and anti-competitive conduct.

17. There are several risks involved in the private enforcement of RBC laws, especially if these do not rely on pro-competitive principles, but also if they do. An imminent danger is that undertakings might seek access to their competitors' purchasing prices and conditions through private discovery. Such

discovery would increase transparency amongst competitors and would thus ultimately restrain competition between retailers. According to German procedural rules, such discovery is not possible. Typically, it will be difficult for a plaintiff to prove what the exact cost price of the defendant is or was. Private enforcement of the RBC provision thus only plays a very minor role in Germany, if at all. According to Section 90 ARC, German courts are obliged to inform the Bundeskartellamt about all proceedings concerning antitrust law. The Bundeskartellamt receives notifications on approximately 250 civil proceedings each year. The Bundeskartellamt is not aware of any civil proceedings on the specific RBC provision (Section 20 (4) 2 ARC) during the past years. However, plaintiffs may base claims on the consumer protection provisions in the Unfair Competition Act. Also, there is scope for follow-on lawsuits seeking indemnification in cases which were decided upon by a competition authority. The court deciding on a follow-on lawsuit is bound to the competition law offence established previously as far as that decision has become final (Section 33 (4) ARC).

18. Due to the problems associated with private discovery in the context of RBC law, it is preferable to rely on public enforcement instead. Entrusting competition authorities with this task (as opposed to e.g. local governments) lowers the risk of anti-competitive enforcement actions. The Bundeskartellamt does not frequently receive complaints about alleged violations according to RBC law. In applying the RBC provision, the Bundeskartellamt focuses on cases where predatory intent or effect and/or further deterioration of already concentrated market structures is conceivable. The most important case of its enforcement experience is reported below.

## **2.2 Case example: Wal-Mart / Aldi Nord / Lidl**

19. In its decision of 7 September 2000 the Bundeskartellamt prohibited the companies Wal-Mart, Aldi Nord and Lidl from selling certain basic foods such as milk, butter, sugar, flour, rice and vegetable fat below their respective cost prices. The three companies are major supermarket chains which operate in concentrated German retail markets. Owing to their size, market shares and resources the three firms have superior market power over the independent grocers that are their small and medium-sized competitors.

20. They had been selling between five and ten items below cost price since the end of June 2000. Wal-Mart took the lead by cutting prices in the middle of June 2000 and undercut not only the sales prices of its competitors legally but also its own cost prices illegally. Aldi Nord reacted to Wal-Mart's price campaign by undercutting both the Wal-Mart prices and its own cost prices. In addition, Aldi Nord lowered its prices below cost price in regions in which Wal-Mart did not operate. Lidl for its part matched the Aldi Nord prices, however not only in Aldi Nord's geographic area of business but also in the south of Germany where Aldi Nord does not operate.

21. The manufacturers' selling prices, including all the price reductions, discounts and other price-related terms that are attributable to the items in question, were used in determining the cost prices. These prices had also been confirmed by the suppliers. There was no objective justification for selling these products below cost. They are not perishable goods, and the three companies cannot claim that they have matched rivals' prices.

22. The investigations showed that consumers ultimately would have suffered from these below cost price sales. The short-term benefit to the consumer resulting from these sales below cost price was not only temporary but also marginal. On the other hand, permanent and appreciable damage would have been done to competition, as some competitors might have exited the market, which would have led to further concentration. In the medium and long term the remaining suppliers would thus have had greater scope to raise prices, not merely of these few "special-offer" products but of their entire range.

## NOTES

1. Economic theory suggests that there are some situations where below cost pricing may be rational without any predatory intent or predatory effect: One example is introduction phases of new products (e.g. customers might initially have little knowledge about the product, or the customer's willingness to pay may depend on the quantity of other users due to network effects). Another example is complementary goods where below-cost pricing of an "entry" product might be paid off by subsequent purchase of complementary products or services (e.g. printers & ink/toner, razors & blades, mobile phones & phone calls).
2. DAF/COMP(2005)103