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Working Party No. 3 on Co-operation and Enforcement

ROUNDTABLE ON BUNDLED AND LOYALTY DISCOUNTS AND REBATES

-- Turkey --

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The attached document is submitted by Turkey to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 10 June 2008.

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1. Generally, sellers offer discounts in order to increase their sales volume against their competitors and to encourage buyers (retailers) to promote their products. In this vein, such practices are expected to increase consumer welfare by lowering prices and increasing production and consumer choices. Nevertheless, such practices also generate anti-competitive effects such as market foreclosure or exclusionary effects. It is also truism to argue that the discounts arise in various different forms which would make it quite harder for the competition agencies to examine them in a consistent way. Last but not least it is also important to underline the fact that anti-competitive effects of discounts depend on the market power of the undertaking offering those discounts.

2. This contribution will try to focus on discount systems in general. Then it will try to elaborate on loyalty discounts that refer to the practice of offering discounts upon the condition that the customer obtains all purchases or at least an important part of its purchases from the seller and it does not buy from the seller's rivals. To that purpose, various decisions will be summarized to provide the approach of the Competition Board after mentioning the statutory provisions.

1. Statutory Provisions

3. The Act no 4054 on the Protection of Competition (Competition Act) has no statutory provisions expressly dealing with discounts, target discounts or loyalty discounts. However, articles 4 and 6 in the Competition Act are the general provisions that would lead the Competition Board to deal with the anti-competitive effects of the discounts, target discounts or loyalty discounts while giving its decisions.

4. Articles 4 and 6 of the Competition Act deal with the anti-competitive effects and the abuse of dominant position respectively. The Competition Act prohibits anti-competitive agreements, decisions and concerted practices in article 4, while it prohibits abuse of dominant position in article 6. Both of the articles, 4 and 6, list non-exhaustive types of restrictive agreements and abusive cases respectively. On one hand, discounts can be analysed under article 4 as those practices generally emerge in the form of vertical agreements. On the other hand, discount systems can be dealt with under article 6 as well. In fact, the discount practices especially loyalty discounts are evaluated in case the undertaking is dominant in at least one market. Those practices may constitute abuse if the dominant undertaking either abuses its position via its practices in the market where it is dominant or tries to extend its dominant position to another market where it is not dominant (leveraging).

2. Competition Board decisions

5. Although the Competition Act does not have specific provisions for discounts, target discounts or loyalty discounts they are examined in Competition Board decisions in a detailed way especially when they have anti-competitive effects on the market such as foreclosure or exclusion. Those practices are evaluated especially in case the undertaking is dominant in at least one market. All the decisions below, except *Ülker,* were initiated on the basis of a complaint, only *Ülker* case was initiated on the basis of an informing and all of them were examined under article 6 of the Competition Act that regulates abuse of dominant position.

6. *Frito Lay*[1] decision is among the most important cases concerning discounts. The Competition Board examined whether the discounts provided in return for exclusive agreements are violating the Competition Act. In fact, this is a dominant position case initiated as a result of the competitor's complaints and discusses whether a dominant undertaking's exclusive agreements with retail outlets for sale of only its products complicate the rival's activity and constitute abuse. The Competition Board analyzed the discount systems in addition to other conducts of the dominant undertaking. Concerning

[1] *Frito Lay* (6.4.2006, 06-24/304-7)

discounts, the Competition Board stated that it is necessary to examine the effects of the discount offerings of Frito Lay on the market in return for exclusive agreements with retail outlets rather than accepting them as a *per se* violation. However, the conduct of Frito Lay, the dominant undertaking in salty snack market, in the form of discounts, products for free and cash in return for exclusivity was proved to be realized in limited time periods and limited areas and therefore such a conduct was deemed to produce limited effect with no power to drive the competitor out of the market. Therefore, no abuse was found by the Competition Board. Although the discount system which was examined in the Frito Lay case was a relatively simple one rather than a complex discount system, this decision is quite important due to the fact that the Competition Board adopted an ”effects-based” approach instead of a form-based approach.

7. In another case initiated upon a complaint against *Microsoft Turkey*[2], the Competition Board initially mentioned that the discounts and supports granted by the dominant firm may be regarded as abuse if their object or effect is to provide incentives for the intermediaries to sell only the products of the dominant undertaking. Respectively, the Competition Board has not found existence of abuse as participation in and conditions of the quantity discount system provided by Microsoft were "open and objective" and no finding indicating that the effects of the this discount system distort competition has been detected. In line with the *Frito Lay,* this decision also considers the effect of the discount systems. Moreover, it also takes into consideration the object of the system. In brief, this assessment provides an insight to dominant undertakings as to how the discount systems should be designed in order to avoid antitrust investigations.

8. *Turkuaz*[3] decision is a good example to show how the Competition Board defines and discusses loyalty discounts. Turkuaz is the new brand of Coca-Cola Selling and Distribution Company (CCSD) in the water market in Turkey. CCSD is the company which is in charge of marketing, selling & distribution activities of Coca-Cola Bottlers of Turkey (CCBT). CCBT carries out its production & bottling activities via another company again based in Turkey. The complaints include unlawful marketing strategies of Turkuaz water brand at the final sales points in a way to exclude rivals and the sale of Coca-Cola products to those resellers at lower prices which also sell Turkuaz water. The decision discusses whether CCSD is excluding its competitors from the market via applying loyalty discounts on its resellers. Two relevant markets are determined in the decision. The first one is the "water market" where there exists the possibility of the infringement of competition and the second one is the "cola soft drinks market" that could be used as a tool to infringe competition in the water market.

9. The Competition Board states that loyalty discounts are a type of price discrimination. Price discrimination represents the selling of a product at different prices in separate markets. There are some conditions for the success of price discrimination. In this regard, the Competition Board decision says that the undertaking shall have market power, separation of the market on the basis of customer groups which have different demand elasticity for the same product shall be possible and the resale between various groups shall be prevented.

10. According to this decision, loyalty discount refers to the practice of offering discounts upon the condition that the customer obtains all purchases or at least an important part of its purchases from the seller (dominant) and it does not buy from the seller's rivals. Loyalty discounts are considered abusive as they prevent customer's obtaining its needs from other undertakings and decrease the rivals' chances of competing on the market. Loyalty discounts have two open effects. Firstly, loyalty discounts act as a barrier to entry with respect to newcomers and they can drive competitors out of the market. The aforementioned effects of loyalty discounts can be considered acceptable in highly competitive markets.

2 *Microsoft Turkey* (1.9.2005; 05-53/809-219)

3 *Turkuaz* (23.1.2003 ; 03-06/59-21)

However, in markets where dominant undertakings exist, such conducts might distort competition. The basic difference of loyalty discounts from other types of discounts is the fact that the seller grants discounts on the condition that the customer shall not buy from its rivals. Loyalty discounts are also different from promotional discounts that could be practiced for short time periods at the beginning of the launching of a new product into the market without any condition on not to buy from the rivals. The buyer's consent or demand is irrelevant in abuse analysis. In addition to that, discounts with an increasing rate can be considered as loyalty discounts especially when their effects are taken into consideration. Indeed the exclusionary effects of loyalty discounts are greater than their discriminatory effects.

11. Concerning the evaluation on loyalty discounts, the Competition Board analyses depend on whether the CCSD has a significant market power or not in the relevant markets. Moreover, during the preliminary investigation, the Competition Board evaluated whether there is discrimination among resellers due to this conduct and whether the conduct could drive rivals out of the market. The invoice examinations of the final sales points on the market showed that the prices that are paid by final sales points that sell Coca-Cola products and Turkuaz water together and the prices paid by final sales points that sell either Coca-Cola products or Turkuaz separately do not differ. In other words, invoice examinations showed that discount rates for Coca-Cola products are determined independently from those for the sale of Turkuaz water. Furthermore, communications with the dealers showed that to have all the products distributed by CCSD is not a determinative factor on the discounts that would be provided by the CCSD. Dealers prefer to sell Turkuaz brand water due to cost advantages when compared to other rival water brands. Another observation puts forward that if there is not enough demand for Turkuaz water, dealers could stop buying this product and as a result the discounts or due date conditions they would get for the purchases of Coca-Cola products are not affected at all. These findings pointed out that there is no discrimination since the launching of the Turkuaz water brand with respect to vertical relations. As loyalty discounts are provided on the condition that rival's products should not be purchased, their expected *de facto* effect would be to complicate the activities of the rivals in the market. But only 4 % of the total final sales points sell exclusively Turkuaz brand. Again, evidence showed that rival water brands had significant market power in some regions. Against this backlog, the Competition Board decision found that there is no loyalty discount enforcement based on refusal to purchase rival products.

12. Competition Board's *Ülker*[4] decision, like the *Turkuaz* decision above, provides certain explanations and principles as to how discounts would be evaluated under the provisions concerning abuse of dominant position in the Competition Act. The case concerns distribution system of the dominant supplier, namely Ülker, operating in many fast-moving consumer goods markets and being dominant in markets for biscuits, chocolates and products coated with chocolates. Ülker has a system of contracts with certain retailers that it calls customers with special status (CSS) and the contracts include, among others, clauses regarding various discount programs. This decision briefly discusses Ülker's retail distribution system, having a discount system with an increasing rate. On one hand, separate discount systems are applied for each product group marketed by different marketing firms belonging to the same group rather than a single discount system for sale of all products marketed by these firms. Then, it states that exclusionary effect of the conduct is weakened due to difficulty in transferring market power from one market into another one, i.e. so called leveraging effect. On the other hand, the Competition Board decision says that Ülker is offering standard discounts to all product groups including those over which Ülker has market power and moreover buyers do not feel obliged to sell Ülker products. As a result, the Competition Board states that such activities can not be regarded as abuse of dominant position.

13. Firstly, the decision defines, within the context of the case in question, target discounts as discounts granted whenever sales target determined for a certain period is reached. Target discounts contain separate rates for each level determined according to the quantity purchased instead of a single

[4] *Ülker* (2.6.2005; 05-38/487-116)

rate. Regarding target discounts with increasing rates, the purchaser is entitled to receive higher discounts if he purchases at quantities corresponding to a higher level. Such discounts may indirectly be equivalent of non-compete clauses if the contract between the CSS and the dominant undertaking lacks an overt non-compete clause.

14. *Ülker* decision admits that discounts based on efficiency gains are acceptable from competition law perspective. However, loyalty discounts as incentives to increase loyalty of the buyer may be considered abuse.

15. According to the decision, loyalty discounts are designed by the dominant undertakings independent of products purchased and in a way to make the buyer buy as many his requirements as possible from them and to prevent the buyer from purchasing from rival undertakings. In this sense, whether there is a single fixed discount in return for buyer's purchase of all of his requirements from the supplier or there are increasing rates depending on the size of the requirements satisfied from the supplier is irrelevant in deciding the existence of loyalty discounts.

16. In this context, the decision mentions that if the discount with increasing rates depending on the percentage of requirements of the buyer independent of the quantity purchased results in purchase by the buyer of all or a significant amount of his requirements from the dominant supplier in order to get more discounts, then it will be regarded as loyalty discount in terms of its effect. Secondly, if the discount is not based on a certain percentage of the requirements of the buyer, but based on quantity purchased and implemented in increasing rates, then it is possible that the dominant undertaking can predict buyer's requirements beforehand and adjust the upper limit of the discount according to buyer's requirements. In this context, although the discount would seem to be dependent on the quantity purchased, it will be regarded as loyalty discount as it is designed to capture all of buyer's requirements.

17. In *Ülker* case, discount is granted at fixed rates for all the CSS in question rather than separate discount systems structured corresponding to requirements of each CSS concerned. Therefore, at first sight it is decided that the discount system is not designed to make the buyer purchase a significant part of its requirements from Ülker, the dominant undertaking, and as a result there is no abuse.

18. One other aspect of Ülker's distribution system is the fact that Ülker has five marketing firms, each distributing different fast-moving consumer products. However, as CSS are granted separate discounts by separate marketing firms in contrast to a single discount based on sales of all Ülker products, it is regarded that exclusionary effect caused by Ülker's wide product portfolio is weakened. For instance, one of Ülker's marketing firms, namely Atlas, distributes products such as biscuits and chocolates for which Ülker holds dominant position in the market. Regarding other products distributed by Ülker's remaining four marketing firms; Ülker does not have a powerful position. As a result, there is no leverage effect meaning transfer of market power into another market because there are separate discount systems. In order that market power of Atlas had been transferred to other product groups distributed by the remaining four marketing firms, it is required that Ülker would have adopted a single discount system.

19. Although actual effects of the discount system applied by the dominant undertaking have not been to prevent new entry or complicate activities of the existing competitors, the Competition Board also takes into account the potential impacts of the distribution system including its discount scheme. It is observed that the share of contracts concluded with CSS in retail distribution system and therefore affected part of the market is minimal. On the other hand, significant part of the remaining market is composed of shops that are the traditional channels of distribution. The Competition Board considers that in case Ülker extended the system of such contracts to cover these traditional channels of distribution or establishes a similar system for them, then potential effects of these contracts could arise in a significant part of the market. By taking into account the existence of such potential effects restricting competition, the

Competition Board has decided that the relevant technical department should monitor the market. This assessment shows that the follow-up procedure aims to prevent the transfer of potential effects into actual effects that could infringe competition in the market.

20. In a recent Competition Board decision namely *Amadeus*[5], Amadeus is the distributor of the 'computerized reservation systems services' in the travel services market. This market is an oligopoly market and there is high dependency to Amadeus services in the market since Amadeus is the first player that entered into the market. Amadeus concludes agreements with its agents including exclusivity clauses entailing provisions on not to provide discounts to agents in case agents would use rival systems. However, those agreements form only a small portion of the market (signed with only 5 agents out of more than 500 agents) and the agents accept those conditions willingly. Furthermore, the decision states that Amadeus is not complicating or intending to complicate the activities of its competitors in the market. In addition, there is no discrimination with respect to other existing agents of Amadeus. As a result, the Competition Board decision states that there is no need to initiate an investigation against the discount system provided by Amadeus, the dominant firm, to its five agents in return for exclusive agreements as they only form a small portion of the market based on the agents' consent. Nevertheless, the Competition Board decision further states that in terms of potential competition limited harm may occur in the competitive structure of the market and thus the agreements shall be terminated.

3. Conclusion

21. The Competition Act does not have specific provisions for discounts, target discounts or loyalty discounts. Yet they are examined in Competition Board decisions in a detailed way especially when they have anti-competitive effects on the market such as foreclosure or exclusion. Those practices are evaluated especially in case the undertaking is dominant in at least one market. The Competition Board takes into consideration effects based approach in dealing with discounts (*Frito Lay, Microsoft Turkey and Turkuaz* decisions). Moreover, the Competition Board tries to avoid turning of potential effects into actual ones (*Ülker* decision) while carrying out its analysis with respect to practices including various discount systems. Similarly, in its *Amadeus* decision, the Competition Board stresses the potential effects of the discount systems rather than only focusing on their current actual effects. Although the Competition Board tries to analyse the discount issue on a case by case basis, there is still room for improvement to have an economic approach regarding discounts, loyalty discounts and single product loyalty discounts.

5 *Amadeus (3.1.2008; 08-01/6-5)*