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ROUNDTABLE ON FIDELITY REBATES

-Note by Egypt-

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More documents related to this discussion can be found at www.oecd.org/daf/competition/fidelity-rebates.htm

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LOYALTY REBATES UNDER ARTICLE 8 OF THE EGYPTIAN COMPETITION LAW (ECL)

1. Introduction

1. This memorandum offers a summary and brief analysis on the Egyptian Competition Authority (ECA) policy under the provision of Article 8 of the Egyptian Competition Law (ECL)¹ which prohibits the abuse of dominant position on a relevant market. This note should address in particular the rules applicable to “Fidelity Rebates” and the ECA policy in this area. Under the ECL exclusive dealing arrangements can be caught either by Article 7 in case they arise in the form of vertical restraints by non-dominant undertakings or by virtue of Article 8 which prohibits exclusionary practices, including fidelity rebates, emanating from undertakings in dominant position on a relevant market. This memo deals only with rebate schemes which come in the context of the prohibition of abuse of dominant position under Article 8 –(c) of the ECL.

2. The context of fidelity rebate investigation

2. The fidelity rebates are rewards or discounts given to customers who purchase all or a specified portion of their requirements for a given product or service from a dominant firm, also can be defined as “pricing structures offering lower prices in return for a buyer’s agreed or de facto commitment to source a large and/or increasing share of his requirements with the discounter”²

3. As mentioned earlier ECL differentiate if the fidelity rebate arises from undertakings in dominant position or not. The ECA assume that if the fidelity rebates is ascending from a dominant firm in a way that leads to exclusivity, this should be having a harmful effect. In order to understand the rational and presumption of this assumption, this paper will explore ECA policy under the area of abuse of dominance, followed by the special responsibility of dominant undertakings as a mean for protecting economic freedom in a 1st place. After that the paper will elaborate more about the loyalty rebate in the context of the special responsibility and the economic analysis and at the end we will explain the Egyptian experience in fidelity rebate (Ezz steel case).

3. The ECA policy under the area of abuse of dominance

4. Due to some economic conditions ECA designed a policy that focus on restraining the economic power of dominant firms, i.e. the preservation of undistorted competition in order to enhance the competitiveness of the Egyptian economy. This considered as a paramount objective by the Egyptian government in its ambitious “2030 Strategic Action Plan for Maintaining Sustainable Developments” (hereinafter 2030 Action Plan) which stressed on the need to encourage and protect small and medium-sized companies that work alongside big companies.³ Another integral part of the philosophy based on

1 It is the Law N. 3 for the year 2005 issued in 15 February 2005 and entered into force in 16 May 2005.

2 <http://www.oecd.org/competition/abuse/2493106.pdf>

3 The Egyptian Government Report on ‘Sustainable Development Strategy: Egypt’s Vision 2030 and Medium Term Investment Framework’ (14 February 2015) < <http://www.mop.gov.eg/Vision1.pdf> > accessed 3 May 2016

which this action plan is established is the need to establish market conditions that lead to price stability through increased levels of economic activity that contributes in reducing unemployment.⁴

5. Accordingly, the ECA believes that its policy in the field of abuse of dominance must work in consistency with the economic realities in which the law is implemented and must also mirror the government priorities in achieving the foregoing goals. The absence of competition policy when liberalisation and privatisation occurred, in 1991, meant that public monopolies were simply transferred to private entities, without any consideration if the monopolistic structure of the market would be altered in favour of a more competitive business environment.⁵ Therefore, under these conditions, a pragmatic and effective competition policy would seek to prevent the accumulation of private economic power in order to sustain economic development. However, it should be noted that later on the government changed its policy regarding the privatization policy to take in to consideration not to privatise companies that holds dominant position within the Egyptian market through requesting the ECA opinion on the privatisation before its implemented.

6. Accordingly, the ECA believes that its competition policy must focus on preventing dominant firms from using their economic power to undermine the market's competitive structure. This harm occurs when dominant firms restrict market players' economic freedom which means a restriction to their rights and opportunities as market operators.

7. The ECA is currently working closely with the EU and the Bundeskartellamt in designing abuse of dominance guidelines that should reflect the legal aspects of the ECA policy that focuses on the protection of Economic freedom. In the ECA's view, the emergence of a strong competitive structure within the Egyptian market may potentially lead to economic efficiency and consumer welfare. The presence of more than one competitor that competes under fair and equal terms may potentially improve allocative efficiency and dynamic.

8. Nevertheless, it is to be expected that the ECA's position in this regard will be evolving naturally once the highly concentrated market structure is altered and competition culture is entrenched. This natural process took place previously in other jurisdictions such as that of the USA.⁶ The same concern is still predominant in Europe for several reasons among them market integration as well as other social policies. Likewise, in Egypt the imperative of creating a competitive economy induces the ECA, at least during the current life cycle of the law, to pursue a competition policy that aims to protect the plurality of market participants in order to guarantee better economic performance in a highly concentrated economic environment such as that of Egypt.

4 *ibid*

5 Ikram (n **Error! Bookmark not defined.**) 84

6 Before the emergence of the Chicago school and the post-Chicago school, during the 1940s until the 1970s, the USA competition policy focused on the preservation of the competitive process as such and a prescription of norms of fair conducts. The so-called Harvard "structural" school has influenced the American jurisprudence that was concerned at that time with the creation of a competitive economy. This can be traced in the US Supreme Court decision at that time which stated that:

Throughout the history . . . it has been constantly assumed that one of their purposes [antitrust laws including the Sherman Act] was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.

US vAluminium Co of America 148 F2d 416 (2d Cir 1945); See Liza Lovdahl Gormsen, 'The Parallels between the Harvard Structural School and Article 82 EC and the Divergences Between the Chicago-and Post-Chicago Schools and Article 82EC' (2008) 4 European Competition Journal 221, 223

9. The ECA endeavours to learn from the EU experience in this field, in particular the line of cases that emphasized the aforementioned objectives and that will underpin the ECA's mission in protecting the process of competition taking into consideration the differences in the economic conditions between Egypt and EU Member States. For this purpose, under the auspices of the Egyptian Ministry of International Cooperation a twining contract⁷ with the EU took place under the framework of bilateral Association Agreement between Egypt and the EU (hereinafter the Association Agreement).⁸

10. The purpose of the twining project is to ensure that "a competitive economic environment in Egypt can develop, which will accrue benefits to the economy, consumers and society at large".⁹ As such, and in line with the aforesaid statement, the ECA will take into consideration the EU experience while drafting the abuse of dominance guidelines. Moreover, the guidelines would primarily be drafted to reflect the economic conditions and priorities of Egypt. To strike this balance, the ECA when drafting its abuse of dominance guidelines will consider the position that competition policy is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the structure of the market and thus competition as such (as an institution), which has already been weakened by the presence of the dominant undertaking on the market.

11. Furthermore, the ECA is aware that a policy that aims for the protection of the competitive structure of the market may overlap with both the State and politically powerful undertakings. This is because a policy that protects the freedom of competition focuses on eradicating barriers hindering entry, and, as discussed, nearly all barriers arose due to different involvement of the State that became to a large extent the sources of private and public restraints.¹⁰ Therefore, the ECA believes that one way for addressing this situation is to impose on dominant undertakings a special responsibility not to allow their conduct to impair genuine undistorted competition on the Egyptian market. The next point will elaborate how the ECA perceives and interpret the concept of special responsibility and how it impacts the analysis of fidelity rebates.

4. The Special Responsibility of Dominant Undertakings

12. Reaching a dominant position is not itself prohibited under the ECL. Dominance exists when 3 cumulative conditions are realised:

- an undertaking owns a market share above 25% and
- the undertaking can exercise effective impact on prices and/or quantities and
- No ability of its competitors to limit such ability

7 The Egyptian Ministry of International Cooperation and the European Union Twining Contract for 'Building the Capacity of the Egyptian Competition Authority' entered into force December 2014.

8 Council Decision 2004/635/EC of 21 April 2004 concerning the conclusion of a Euro-Mediterranean Agreement establishing an Association between the European Communities and their Member States, of the one part, and the Arab Republic of Egypt, of the other part EU-Egypt Association Agreement [2004] OJ L304

9 EU-EGYPT Action Plan <http://eeas.europa.eu/enp/pdf/pdf/action_plans/egypt_enp_ap_final_en.pdf> Accessed 27 April 2016, 19

10 Bahaa Ali el Den an and Mahmoud Mohieldin, 'On the formulation and enforcement of competition law in emerging economies: The case of Egypt' (2001) working paper no 60 the Egyptian Centre for Economic Studies<http://www.eces.org.eg/Uploaded_Files/%7B7D725DFD-E6DC-46C8-916A-DB55BC51F603%7D_ECESWP60e.pdf> accessed 15 April 2016, 22

13. The prohibition of abuse of dominance are stipulated under article 8 of the ECL.

14. Article 8(a) prohibits an undertaking in a position of dominance from committing “any” act which may have the actual or the potential effect of impairing, totally or partially, the manufacturing, the production or the distribution of a given product over a given period(s) of time. The Executive decree defines the term “period” as refereeing to this period sufficient to restraint, distort or harm the freedom of competition.

15. These provisions effectively put on dominant undertakings a special responsibility not to allow their conduct to impair undistorted competition in the Egyptian market. The presence of such principal deprives dominant undertakings from adopting certain kinds of conduct that would have been unobjectionable if taken by non-dominant rivals. This represents the underlying reason for having a list of prohibition addressing only certain types of behaviours emanating from dominant undertakings.

16. It follows that a dominant undertaking is prohibited from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the merits. Competition on the merits is the normal competition between products, based on an undertaking’s performance in the market, such as: offering lower prices, better quality and wider choice of new and improved goods and services. The extent to which fidelity rebates would fall foul article 8 of the ECL is subject to the assessment within the next section.

5. Loyalty rebates in the context of the special responsibility of dominant undertakings

17. In addition to article 8(a) stated above, article 8(c) prohibits a dominant undertaking from committing any act that may lead to the exclusivity of distribution of the product(s) of the dominant undertaking to the detriment of other competing products. Moreover, article 8(i) prohibits a dominant undertaking in a downstream market from committing any act that may lead the suppliers to terminate their relationship with another downstream competitor or reduce their supply to the extent that threatens the existence of the downstream competitor in the market or ultimately force the non-dominant competitor to exit the market or limit the freedom of potential competitors from entering the market by making such entry more onerous.

18. The special responsibility of dominant undertakings entails that these undertakings are required to act as if they were faced with complete competition, i.e. the absence of market power of individual firm. Therefore, in the ECA view, for establishing an infringement of article 8 it is sufficient to show that the rebate scheme of the dominant undertaking tends to restrict competition, or is capable of having exclusivity effect. In particular, the ECA would assess whether the alleged infringement would interfere with the independence of firms in their commercial relations with the undertaking in a dominant position by making them more dependent on the dominant undertaking to the detriment of other competitors and competition as such.

19. The difficulty with rebate schemes is that while they tend to offer end consumers or customers lower prices over the short run, they tend to harm the competitive structure of the market on the long run. Because of the problem of asymmetric information, it is tempting for customers or consumers to accept the discounts offered to them, thereby ignoring the effect of receiving these discounts on the longer run.

20. Therefore, when conducting an assessment for rebate case, the ECA will generally consider the following (non-exhaustive) factors:

- all the circumstances of the case particularly the criteria and the rules applicable for granting the discount;

- whether in the provision of the discount is based on normal quantities discounts as opposed to target discounts;
- whether the discounts is loyalty enhancing in particular whether the discount tends to remove or restrict the buyer's freedom to choose his sources of supply in a way that may restrict the freedom of other suppliers in competing with the dominant firms;
- whether the rebate scheme involve applying dissimilar conditions to equivalent transactions with the dominant firm's trading partner in the sense of article 8(h) of the ECL;
- whether the rebate scheme has the object or capable of, or likely to strengthen the dominant position by limiting the ability of other competitors to compete on equal terms.

21. The ECA guidelines on abuse of dominance will shed more light on how the ECA will conduct its assessment under each of the foregoing factors.

22. However, the Egyptian Court of Cassation ruled that abuse under article 8 –c (exclusivity) is an objective concept that does not depend upon intention to cause harm to competition but only on the intention of engaging in exclusivity arrangement which is presumed by entering into the exclusivity arrangement itself. In other words, harm to competition is presumed by engaging into the exclusive arrangement.

6. The role of economic analysis in the area of fidelity rebates

23. Economic analysis can be helpful to ECA analysis when proving whether the scheme in question would likely have a restrictive effect on competition, i.e. how likely the foreclosure may be as a result of the scheme. This would be important in case the rebate is addressed under articles of law other than 8 –c (exclusivity) i.e if the rebates is examined under predation or the general provision of article 8 –a mentioned earlier.

24. That being said, it is also worth mentioning that “where an undertaking in a dominant position actually implements a practice whose object is to oust a competitor, the fact that the result hoped for is not achieved is not sufficient to prevent that being an abuse of a dominant position”.¹¹ In addition, the fact that the rebate scheme did not yet generate concrete effect should not, in the ECA view, harm the finding of abuse.

25. Moreover, the growth of market shares of the dominant firm's competitors when the rebate scheme was implemented does not imply that the scheme did not produce or will not produce harmful effect because it can be reasonably expected that the rise of market shares can be even stronger in the absence of the rebate scheme. Therefore, economic analysis can be amongst the useful tool to prove the theoretical likelihood of foreclosure, yet it is not a condition for the finding of abuse.

26. As stated earlier, the ECA policy is not designed only or primarily to protect the immediate interests of individual competitors or consumers, but to protect the *structure of the market* and thus *competition as such*. Therefore, when considering whether the ECA policy should only protect those “as equal efficient competitor”, this should be balanced against the highly concentrated market structure in Egypt and the priority of protecting small and medium-sized firms as emphasized in the government 2030 Action Plan. The application of this test presumes the presence of efficient dominant firm and the likelihood of efficient competitors. While this presumption can be readily accepted in other jurisdictions

11 Case T-340/03, France Télécom v. Commission, 2007 E.C.R. II-107, para 196

such as Europe for instance, it hardly fits the economic conditions in Egypt where market structure, in addition to other factors, do not lead to similar level of innovation and other types of economic efficiency.

7. The ECA decisional practice in the area of fidelity rebate

27. As mentioned earlier, the loyalty rebates can be examined under various provisions of article 8 on abuse of dominant position of the Egyptian competition law, especially article 8(c) on exclusivity that also covers “de facto exclusivity”. The case-law of the loyalty rebates in Egypt is still very limited with hardly one case related to a quantity forcing leading to a loyalty rebate.

28. Generally, the ECA defines “quantity-forcing”¹² as the scheme that operates to encourage or even require a purchaser to obtain its supplies from the seller operating the scheme.

29. e.g. Quantity forcing: a wholesaler should be achieving a monthly target of **105** units sales will maintain this same quantity in future supply, in case of attaining a less amount he will be punished by reducing his quota in this case if he reaches **100** Units he will only get this sum for the next order.

30. Loyalty Rebate: a wholesaler required achieving 100 units’ sales to get a discount for 5 units meaning **105** units in his credit, else if he trades the **100** units only he will maintain this same level in future orders with no discounts.

31. Quantity forcing refers to pricing schemes that reward a buyer for purchasing some threshold quantity from a firm such quantity forcing may be specified either by reference to a share of the purchaser's total requirements or in numerical terms¹³

32. In the case investigated by the ECA, the dominant undertaking was retroactively rewarding those purchasers that were able to meet their targets thereby making it less attractive for them to switch their demand to alternative suppliers. The case is commonly known in Egypt as the El Ezz Steel Case.

El Ezz steel: The application of a quantity forcing by the dominant undertaking in the steel case

33. The relevant product was steel rebar sold in Egypt. There were 20 companies working in the steel manufacturing market. Nevertheless, the ECA found that el EZZ Group was holding a dominant position on the relevant market for the following reasons:

- El Ezz Group owned 58% market share

12 Quantity forcing can be defined as "a weaker form of single-branding by which a supplier requires its buyers to purchase or sell at least certain quantity of the supplier's products during a given period of time. Quantity forcing can be imposed through contractual obligations or non-linear quantity rebate systems, fidelity rebate systems or two-part tariff systems whereby the supplier charges a fixed fee plus a price per unit purchased. While quantity forcing does not directly prevent the reseller from purchasing or selling competing products, it can have effects which are equivalent to a direct non-compete obligation. This will especially be the case if the size of the minimum purchase or sales obligation is significant in relation to the reseller's total purchasing requirements for products belonging to the same product market, since the reseller may have to refrain from purchasing competing products in order to meet its minimum purchase or sales obligations".

MOBLY (S.)- Observations on the Egyptian Competition Law compared with other and Competition regimes, in TRAC/AMCHAM, National conference on competition Law and policy, Cairo, 13 September, 2006, p. 21.

- As the only vertically integrated firm, it enjoyed the ability to control prices and quantities within the market without the ability of the competitors from limiting the said control due, inter alia, to the lack of their integration.

34. El Ezz group was implementing a selective distribution system by virtue of which it obliged its customer distributors to purchase in accordance with a quota system whereby it forced to acquire at least 90% of an agreed volume from el Ezz. Failure of honoring such obligation, distributors will be deprived from purchasing the previously agreed quantities till the end of the contract in force. However, those who will be able to exceed their allotted quantities will be rewarded in their upcoming contracts retroactively.

35. The findings revealed that competitors were not able to compete on equal terms for the entire demand of each individual customer. As such, the exclusive purchasing obligation coupled with the rebate scheme make it nearly impossible for distributors to divert the contestable part of their demand to the competitors' of the dominant firm. Here, economic analysis was useful supporting tool in explaining the harm to competition that flowed from the said strategy although that article 8 –c does not require any proof for to competition in order to establish an infringement.

36. In 2009, based on the foregoing findings, the ECA case handlers concluded that the dominant firm's strategy infringed article 8(c) of the ECL.¹⁴ This has been upheld by the Court of Cassation in Case No. 2898/84. Accordingly, in case of dominance if fidelity rebates lead to exclusive dealing this will violate article 8 (c) of the ECL. Hence, it will be incriminated as a per se illegal.

8. Conclusion

37. This submission endeavoured to present the ECA's policy in the area of loyalty rebate. It identified the reasons underlying the ECA's policy focus on the protection of freedom of competition. It has also illustrated the benefits to Egyptian consumers and the economy as whole from achieving and maintaining a competitive structure basically in creating a level playing field for empowering small and medium-sized enterprises to reduce unemployment; but also to encourage foreign direct investment by making market conditions more attractive, free from artificial barriers, and in which all market players compete on the basis of their performance. More guidance on how the ECA will conduct its assessment in the area of fidelity rebate will be soon released in the ECA guidelines for abuse of dominance.

38. The ECA reiterates the thanks for the OECD for allowing the opportunity to share our policy and practice in this important field of competition law and to exchange opinions with friends from other competition authorities. The ECA also praises the great efforts of the OECD in bringing together competition agencies and experts as part of its endeavour in establishing a platform for discussion about the challenges of enforcing competition law in different countries.

14 For more details on the steel market structure and the findings achieved with regard the dominance, please consult the steel brief and/or the steel report www.eca.org.eg