

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

Working Party No. 3 on Co-operation and Enforcement

ROUNDTABLE ON BUNDLED AND LOYALTY DISCOUNTS AND REBATES

-- Hungary --

10 June 2008

The attached document is submitted by Hungary 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. Section 21 of the Competition Act of Hungary prohibits abuse of dominant position with a wording similar to 82 EC. It contains a non-exhaustive enumeration of prohibited behaviours and though some of them could be related to discounting and loyalty inducing pricing strategies, none of them refers explicitly to such situations. During the last five years the GVH examined two cases (Vj-167/2001, Vj-124/2003) having discounts in their focus, and each case was examined under different headings of Section 21. Infringement was established in only one instance and therefore no general guidance seemed to be necessary to ensure legal certainty concerning such behaviours.

2. Both procedures were initiated upon complaint from undertakings competing with the dominant firm. Complaints alleged horizontal foreclosure by a legal monopolist on a connected market (postal sector) and vertical foreclosure by a network owner (telecom operator). The complexity of the cases, the likeliness of the existence of dominance and the suspicion of foreclosure led the GVH to devote capacities for an in depth investigation of the cases.

3. Infringement was established in the case of the horizontal foreclosure. In this case Magyar Posta (MP), the former monopolist postal service provider that still enjoyed legal exclusivity for certain services, applied a progressively increasing discount system. The proceedings originated from a public tender announced by an electricity supplier (ÉMÁSZ) for the creation, preparation and delivery of its consumer invoices. Two markets were investigated, the market of creating postal items and the market of their delivery. At that time, MP was the exclusively authorised provider of basic postal services, like the clearance, sorting, transporting and delivery of items of correspondence.

4. One of the participants of the tender turned to the procurement supervisory authority, complaining that the electricity company should not have included an activity covered by legal monopoly into the requested service, as it excludes competition even in relation to that part of the requested service, which was not covered by legal monopoly. At first instance the complaint was rejected as unsubstantiated as the procurement authority considered that as MP can be involved as subcontractor into any of the tenders, competition was not restricted in its entirety. However, MP has also submitted a tender in which it provided a special discount for the electricity company on deliveries (the monopolised segment) should MP be chosen for the creation and preparation of the invoices (the competitive segment). This special discount on delivery was not available for other participants of the tender to whom the general progressive discounting framework applied. However as the cost of delivery represented around 60-70% of total costs even a slight deviation resulted in significant alterations in the offers. It was established that often, but not always, MP deterred from its general discounting framework and provided higher discounts where it was also chosen for the creation and preparation of invoices or direct mails. MP has not invoked a detailed efficiency defence for its practice only noted that the level of the discount depends not only on the number of deliveries but also on the level of the preparedness of the items to be delivered. MP claimed that should any of its competitors submit the postal items in the same level of preparedness as MP itself does, it would certainly receive the same special discount promised by MP in certain tenders.

5. The GVH found that this justification could not be accepted. First, the required level of preparedness is determined by regulation and therefore there is no room to make distinctions on that ground. Second, in fact MP refused the application of the same discount in certain cases without regard to the preparedness of the postal items. Third, MP has not consistently applied the special discount in all cases where it provided all the services. All these circumstances suggested that in reality the discount on delivery had no connection with preliminary services, it was arbitrary and non transparent.

6. The reason for the application of the special discount was that MP used its monopoly on the delivery market to restrict and distort competition on the separate, competitive market of the creation of postal items. The special discount system used by MP provided customers with higher discounts if they

contracted MP for the creation of postal items as well, thereby leveraging its market power to a competitive market.

7. In this case no proper cost-price test was applied mainly due to the fact that first, MP itself has not raised an effective efficiency defence, but only put forward efficiency based arguments that proved to be unsubstantiated even before any cost analysis became necessary, and second, because not the effects of a consistently applied discount system in general was at stake but the infringement was rather constituted by ad hoc discrimination aiming the leverage of market power on a connected market.

8. In the other case the GVH did consider cost tests for the discounts applied by the vertically integrated, upstream monopolist telecom operator. Matáv, the incumbent fix telecom provider, kept his position as the owner of the local loop in the majority of the designated territories of Hungary. In certain areas, other competitors, like Invitel took over the network. The owners of the local loop gave access to the infrastructure for ADSL Internet service providers. Through its subsidiary Axelero, Matáv also participated on the downstream market nationwide.

9. In order to encourage the development of broadband Internet facilities, Matáv, as a wholesaler, introduced a system of progressive discounts for its customers, the downstream Internet service providers. According to the number of subscriptions undertaken to be acquired in a given year, Internet service providers were entitled for a discount. Though the discount was not calculated upon the subscriptions de facto acquired during the given period, a penalty system was also envisaged (but leniently applied) for the failure to meet the quota undertaken. Out of 14, only two of the Internet service providers were able to make an undertaking meriting the highest discount level, Axelero the affiliated company of Matáv and an other, independent service provider. The discounts provided to the seven largest Internet providers were between 51.65%, and 49.04%.

10. Axelero has continuously increased its share on the domestic Internet retail market from 52.57% at the beginning of 2002 to 62.03% by the end of 2003. At the same time the shares of the second and third largest suppliers have decreased from 13.25% to 8.07% and from 12.78% to 10.55%, respectively. On the other hand if Internet provided through cable was also taken into account than the share of Axelero was well below 50%. Axelero was also weak on those markets where Invitel was the upstream supplier.

11. Axelero set the same retail prices irrespective of whether the wholesale service was provided at the given territory by Matáv, or by Invitel. This however meant that in areas where Axelero did not receive a discount comparable to that provided by Matáv, it was actually pricing below cost.

12. The investigation focused on three issues. First, whether the wholesale prices set by Matáv and the retail prices set by Axelero constitute a price squeeze. Second, whether the pricing of Axelero qualified as predatory on those areas where the wholesaler was not Matáv. And third, whether the progressive discount system of Matáv was discriminatory.

13. The GVH established that on Matáv's areas Axelero was pricing above costs and therefore no price squeeze was perceivable. Second, it was established that on the areas of Invitel Axelero was not dominant and therefore it had no opportunity to adopt a successful foreclosure, while it had objective reasons for such pricing first, as its entry was delayed by the pricing strategy of the incumbent and therefore had to compete more aggressively, and second because as a nationwide service provider it intended to have the same offer in all areas for marketing reasons. Finally the GVH also gave up the idea that the progressive discount system of Matáv would be discriminative. Matáv admitted that there are no direct efficiencies deriving from the increase of the number of subscriptions from one discount level to the next one. However there are such efficiencies deriving from the overall increase in the number of subscriptions and Matáv passes on these efficiencies on the Internet providers according to their relative

size. The GVH accepted this argument as an efficiency defence and distinguished the case from similar cases of the EC (the airport cases) on this ground. It was also acknowledged that not only Axelero, but an other independent provider also benefited from the highest level of the discount system.

14. In sum the application of discounts have not raised serious competition concerns in Hungary. In the few cases investigated the GVH carefully considered the experience of the EC to be able to construct a solid theoretical background. In its approach the GVH proved to be rather lenient and willing to accept claims of even indirect efficiencies as justification for the discount system. It does require however reference to efficiency gains and a plausible story. It also considers the possibility of discrimination.