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*International Competition Law Update:*

*Germany Requires Wal-Mart to Raise its Prices*

At the beginning of this month the German government ordered Wal-Mart to *increase* its prices in Germany. This decision provides a stark and public example of the differences among US, EC and German antitrust/competition laws and demonstrates clearly that companies doing business in Germany need to be aware of the scope of local law because of the impact it can have on their business in that country. Accordingly, we provide below a brief description of the Wal-Mart case, the legal structure underlying it, and the potential impact of this decision on companies doing business in Germany.

**The Wal-Mart Case**

Wal-Mart has been doing business in Germany since 1998 using superstores that offer both its usual assortment of discount department store goods as well as groceries. Wal-Mart faces fierce competition in the German food retailing market, particularly from the large and well-established Aldi and Lidl chains. In May 2000, in an effort to gain market share, Wal-Mart decided to lower its prices on some basic food items (such as milk) below the price charged by Aldi and Lidl. Some of these new prices were below Wal-Mart's purchase cost for the particular items, making them, effectively, loss leaders. These loss leader promotions continued, in some cases, for more than three weeks. Not surprisingly, Aldi and Lidl responded to Wal-Mart's actions by lowering their prices as well, resulting in a price war, with milk dropping to as little as 43 cents per liter and sugar as low as 75 cents a kilogram.

The German Federal Cartel Office ("FCO") took notice of this price war and opened an investigation pursuant to Section 20(IV)(2) of the Act Against Restraints of Competition (known as "GWB"<sup>1</sup>). Section 20(IV)(2) prohibits businesses "with superior market power in relation to small and medium-sized competitors" from pricing below cost, except when such pricing occurs only

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<sup>1</sup> Gesetz gegen Wettbewerbsbeschränkungen.

“occasionally” and where there is an “objective justification” for the pricing scheme.<sup>2</sup> The FCO also opened investigations of Aldi and Lidl.

On September 1, 2000, the FCO issued decisions finding that Wal-Mart, Aldi and Lidl were each in violation of Section 20(IV)(2) of the GWB for their pricing practices. (Decisions of September 1, 2000, B 9-74/00 [Wal-Mart], B 9-84/00 [Lidl], B 9-85/00 [Aldi]). The decisions found that the relevant market for analysis was foodstuff retailing in Germany, that Wal-Mart, Aldi and Lidl each had “superior market power in relation to small and medium size competitors” in that market, that each retailer had engaged in below cost pricing more than “occasionally,” and that the below cost pricing was not “objectively justified.”<sup>3</sup> The retailers all have until early October to appeal the FCO’s orders before the German courts. If upheld, the effect of these orders will be to require Wal-Mart (and its major competitors) to raise their prices and to prohibit these companies from using similar pricing strategies in Germany in the future.

### **Impact of the Decision**

Any large company selling products or services in Germany should take the Wal-Mart decision seriously. Section 20(IV)(2) has to date been applied only to consumer retailing, and the exact scope of the law’s coverage is still under discussion at the FCO. However, based on a reading of the statute it is possible, and perhaps even likely that the FCO will conclude that the law’s reach extends beyond the consumer retail sector to other retail or even wholesale trading activities. It is important, therefore, for companies making sales in Germany to follow the development of this law, since, while it is unlikely the FCO will go this far, taken to its logical extreme, the law could make illegal any loss leader or other below cost sales by any large seller (regardless of its relative market share in Germany) that extended for any significant period of time. The focus of the German statute is more on the protection of smaller German businesses than on consumer welfare, and thus

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<sup>2</sup> German courts have interpreted Section 1 of Germany’s second major competition statute, the Act against Unfair Competition (Gesetz gegen den unlauteren Wettbewerb, “UWG”), to encompass pricing below costs where such practices are predatory in nature. Unlike US law, German antitrust law does not require proof that businesses be able to recoup predation investments in the future.

<sup>3</sup> In reaching its decision against Wal-Mart, the FCO rejected arguments (1) that Wal-Mart as a mass retailer was in a different market from pure food retailers; (2) that Wal-Mart did not have superior market power because its overall market share was low, particularly relative to Aldi and Lidl, finding instead that the standard under Section 20(IV)(2) was market power *relative to small and medium-sized competitors*, not market power relative to the market as a whole; and (3) that Wal-Mart’s pricing practices were justified by either its need to price aggressively to penetrate the German market or (in the case of sugar) its need to eliminate overstocks, finding that clearance sales, which can be justifiable, are not in the case of non-perishable commodities such as sugar.

the actual competitive impact of the below cost pricing, and its impact on consumers, can be outweighed in the FCO's analysis by the potential for harm to small German businesses.

This is very different from US and EC law which are principally concerned with the protection of competition, not competitors and thus generally view low prices, even below cost prices, as pro-competitive and pro-consumer, absent evidence that the below cost prices are intended to harm competition.<sup>4</sup> Accordingly, as the Wal-Mart case shows, pricing practices that are legal outside Germany could run afoul of Section 20(IV)(2). Accordingly, companies of any significant size should be careful in setting their retail pricing practices in Germany. It is not safe to assume that pricing practices that have passed legal scrutiny in the US or elsewhere will necessarily be legal within Germany. While the statute does not act as an absolute bar to all below cost pricing, it does create limitations on pricing strategies that are not present in major jurisdictions outside of Germany. As mentioned above, the risk is currently clearest in the consumer retailing sector, but the exact scope of the law is unclear, and there is a real risk that the FCO will apply the law to other sectors. We will provide updates in the future of any major developments in this area of German competition law.

Please contact us if you would like further information on the Wal-Mart case or any other issue of US, EC or German antitrust or competition law.

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<sup>4</sup> There is some split in the US between state and federal law on this matter. Under federal antitrust law, below cost pricing is only illegal when it is predatory, meaning that it is intended to eliminate competition, that it has a likelihood of succeeding in doing such harm, and that the party engaging in the predatory pricing has a reasonably likelihood of recouping its losses through supracompetitive prices after competition has been eliminated. *See Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). A number of states, by contrast, have statutes that explicitly prohibit any form of below cost pricing, including, in some states, loss leaders. But even under those statutes proof of sales below cost is not enough; to make out a violation there must be proof that the defendant intended to harm competition. *See, e.g., Wal-Mart Stores, Inc. v. American Drugs, Inc.*, 891 S.W.2d 30 (Ark. 1995).