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International Competition Law Update:

*German Supreme Court Rules Against Wal-Mart
in Below-Cost Pricing Case*

In November 2000, we reported on the German Federal Cartel Office (“FCO”) decision requiring Wal-Mart to *increase* its prices in Germany for certain basic food items (such as milk, margarine, and sugar) that Wal-Mart had sold below its purchase cost. Wal-Mart thereafter appealed the decision to the Düsseldorf Court of Appeals, which ruled for Wal-Mart and reversed the FCO’s decision. The German Supreme Court (known as the Bundesgerichtshof or BGH) has now ruled on the FCO’s appeal from the Court of Appeals’ decision, and has reversed most of that court’s legal conclusions favorable to Wal-Mart, handing the FCO a significant victory. The Supreme Court’s final ruling on the Wal-Mart case has potentially far-reaching implications for any large company selling products and services in Germany.

Background

Wal-Mart has been doing business in Germany since 1998 through superstores that offer its usual assortment of discount department store goods and groceries. In May 2000, it became involved in a price war with two major competitors, the large and well-established Aldi and Lidl chains. Wal-Mart decided to lower its prices for sugar below those of Aldi and Lidl. Wal-Mart’s resulting price was below its purchase cost, thus making sugar, effectively, a loss leader. Wal-Mart also priced margarine and milk below cost although it did not lower its prices for these items in response to competition. Instead, when Wal-Mart encountered a sudden increase of its purchase costs – resulting, at least in part, from undue influence by Aldi and/or Lidl on Wal-Mart’s suppliers – it did not raise them, but decided to maintain previous price levels to avoid losing market share.

Adopting a broad reading of the law, the FCO found that Wal-Mart, Aldi and Lidl each violated Section 20(IV)(2) of the Act Against Restraints of Competition (known as Gesetz gegen Wettbewerbsbeschränkungen or GWB). That provision prohibits businesses “with superior market power in relation to small and

medium-sized competitors” from pricing below cost, except when such pricing occurs only “occasionally” and there is an “objective justification” for the pricing scheme.

The Supreme Court’s Decision

The Supreme Court’s opinion has not yet been publicly released. However, the Court has issued a detailed press release that indicates that it has endorsed much of the FCO’s interpretation of Section 20(IV)(2) GWB.¹ The Court’s decision appears to rely on the FCO’s finding that the relevant market for analysis is foodstuff retailing in Germany, and that Wal-Mart has “superior market power in relation to small and medium-sized competitors” in that market.² The Supreme Court decision focuses on the third element of Section 20(IV)(2) GWB and analyzes whether Wal-Mart was “objectively justified” to sell milk, margarine, and sugar below cost. The Court’s analysis of this issue stands in marked contrast to the Düsseldorf Court of Appeals’ more permissive approach to aggressive pricing strategies.

The Court of Appeals had held below that Wal-Mart’s sales of sugar did not violate Section 20(IV)(2) GWB because Wal-Mart’s price was only marginally below its purchase cost and therefore did not have a “noticeable” effect on competitive conditions for small and medium-sized retailers. The Court of Appeals also interpreted the statute to require a causal link between a retailer’s superior market power and its pricing below cost. The Court found such a link missing where Wal-Mart had not increased its prices for certain other items, but merely maintained previous price levels during a sudden increase of its purchase cost resulting from anticompetitive pressure on Wal-Mart’s suppliers.

The Supreme Court rejected both holdings. Adopting a more literal construction of Section 20(IV)(2) GWB, it held that Germany’s loss-leader pricing statute does not require either a “noticeable impact on competition” element, or the existence of a causal link between superior market power and pricing below cost. According to the Supreme Court, if superior market power and pricing below cost is found, the only relevant inquiry is whether the practices at issue are “objectively justified” under the circumstances of the case.

Turning to the “objective justification” inquiry, the Supreme Court upheld the legality of Wal-Mart’s pricing of margarine below purchase cost because it occurred only for a limited time while Wal-Mart looked for a new supplier. However, the Court reinstated the FCO’s decision with respect to sugar on the grounds that it was immaterial whether Wal-Mart’s practices had a “noticeable

¹ The information provided in this note is based on the press release.

² It is not clear from the press release whether the market definition was at issue on appeal.

impact” on competition. The Court also concluded that Wal-Mart’s below cost prices for milk could not be justified by its asserted need to match competition because Aldi’s and Lidl’s prices also violated Section 20(IV)(2) GWB. The Court held that Wal-Mart’s response “in kind” to Aldi’s and Lidl’s prices increased the likelihood of harm for small and medium-sized competitors and was impermissible in view of the legislative purpose of Section 20(IV)(2) GWB. The Court, thereby, implicitly seems to have endorsed the FCO’s view that Wal-Mart should have reported anticompetitive practices to the FCO and rejected the Düsseldorf Court of Appeals’ holding that Wal-Mart suffered immediate economic harm, and was therefore justified in not waiting for the FCO to intervene.

Impact of the Decision

The Supreme Court’s ruling case has given the FCO important guidance on the reach of Germany’s loss-leader pricing statute. The FCO will have many opportunities to use that guidance in pending loss-leader cases. Although a number of issues remain unresolved – *e.g.*, whether Section 20(IV)(2) GWB might apply outside the retail sector – companies active in Germany should be aware that pricing strategies that may be permissible in the United States (or under EC competition law) might violate Germany’s loss-leader statute. In this context, it bears special emphasis that Section 20(IV)(2) GWB does not require a company to be dominant (or even the largest supplier in the market) for the statute to apply. A “superior market position” *vis-à-vis* small and mid-sized companies is enough.

The Supreme Court endorsement of the FCO’s decision emphasizes that the focus of Section 20(IV)(2) GWB is more on the protection of smaller German businesses than on consumer welfare. Thus, the actual competitive impact of below cost pricing, and its effect on consumers (even if favorable), may be outweighed in the FCO’s analysis by the potential for harm to smaller businesses.

As we have noted in our November 2000 *International Competition Law Update*, the German approach is very different from US federal antitrust 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 harm consumers. Accordingly, companies of any significant size must be careful in establishing retail pricing practices in Germany. Although the Düsseldorf Court of Appeals may have hinted at a more permissive approach, the Supreme Court’s recent decision confirms that it is not safe to assume that pricing practices that have passed legal scrutiny in the United States or elsewhere will necessarily be legal within Germany.

It is important to remember that while federal antitrust law in the United States, below cost pricing is only illegal when it is predatory, many states have laws making certain forms of below cost pricing illegal even absent evidence of predatory intent and the ability to recoup losses at a later time. Many states have adopted “sales below cost” statutes that may prohibit certain below cost sales even though the prices charged are legal under federal law. These state laws may apply to all products or target specific ones, such as gasoline, cigarettes, milk or insurance. Although there is considerable variation among states, the more onerous state laws have potentially broad application because they focus essentially on injury to the plaintiff and do not necessarily require evidence of market power, predatory intent or harm to competition or consumers. A recent example of the potential strictness of state laws is the decision by the Wisconsin Court of Appeals in *Gross v. Woodman’s Food Market*, (Wis. Ct. App., Dist. IV, No. 01-1746, Nov. 14, 2002). There, the court affirmed a verdict of \$586,000 under the state’s Unfair Sales Act for sales of gasoline below cost, despite making no finding of predatory intent or market power. The court also rejected a “meeting competition” defense where the defendant failed to notify the government of price reductions on a daily basis. It is, therefore, wise to exercise caution before engaging in a pattern of below cost pricing, particularly in politically sensitive retail products.

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