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COMMENTARY

UK's Competition Authority Sends Message, Clarifies Criteria for Ruling on Pharma Discounts

The UK's Competition and Markets Authority ("CMA") has closed an investigation under competition rules into certain discounts and rebates in the pharmaceutical sector.[1] Rather than taking enforcement action or concluding that the pricing practice does not infringe UK/EU competition law, the CMA decided to close the investigation against the unnamed party because the case no longer fell within its priorities,[2] but it also sent a warning letter to the company suspected of wrongdoing and issued general guidance as to the CMA's approach in assessing so-called roll-back (or retroactive) discounts and rebates under UK/EU competition law. The following key points may be noted about this case:

- It is the first time that the CMA has issued guidance on roll-back discounts and rebates by a dominant company. The CMA's guidance does not deviate from the established UK or EU competition law position on the use of roll-back discounts and rebates but relies on economic principles previously endorsed by both the EU and U.S. antitrust agencies.
- The fact that the CMA closed the investigation on prioritization grounds rather than on the merits, and that it issued a warning letter as well as general guidance, could suggest that the CMA is concerned that the use of potentially anticompetitive roll-back discounts and rebates may be widespread in the UK pharmaceutical industry or other sectors and that the CMA wishes to highlight what it considers to be unacceptable in the use of such pricing schemes.
- This appears to be consistent with an emerging trend for the CMA, both in cases closed on prioritization grounds or settled by way of commitments, to issue guidance to UK businesses aimed at clarifying the law and communicating a wider deterrence message.

Background

In 2014, the CMA opened an investigation into a suspected loyalty-inducing discount scheme in the pharmaceutical sector that might have been in breach of Chapter II of the UK Competition Act 1998 and Article 102 of the Treaty on the Functioning of the EU, which both prohibit abuses of a dominant position. Neither the name of the company nor the details of the arrangements under investigation have been disclosed.

After several months of information gathering, including meetings with the company, the CMA concluded that further investigation of the conduct would have limited benefit to consumer welfare. In accordance with its own prioritization principles, the CMA issued a

statement announcing the closure of its investigation without any substantive finding as to whether the conduct at issue was lawful or unlawful. However, the CMA emphasized that this did not mean that it would not look into "suspected loyalty-inducing discount schemes in the future." The CMA sent a warning letter to the company concerned and issued further guidance for pharmaceutical businesses in relation to the use of discounts and rebates.

Discounts and Rebates

Discounts and rebates in the pharmaceutical sector entail various forms of reductions in the price paid by the customer for a drug. In its statement, the CMA acknowledged that "the provision of discounts and rebates can benefit both customers—for example, through lower prices—and the business providing the discount or rebate—for example, by helping the firm achieve economies of scale and expand production". However, rebates and discounts adopted by a dominant company may sometimes violate competition rules if they have the effect of locking in customers and excluding competitors (so-called "loyalty-inducing" or "foreclosure" effects).

In the pharmaceutical sector, it is often the case that the originator of a particular drug under patent (and sometimes after patent expiration) will be found to be a dominant supplier of that drug in a national market. Discounts and rebates will rarely if ever be a problem for nondominant companies.

In the recent *Intel* case,[3] the EU General Court distinguished three types of discounts and rebates for competition law purposes:

- Quantity discounts/rebates linked to the volume of incremental purchases made from the dominant firm, which the Court generally considered lawful;
- Discounts/rebates conditional on the customer purchasing "all or most" of its purchases of the relevant product from the dominant firm, which the Court considered inherently unlawful without the need to show even a capability of "loyalty-inducing" or "foreclosure" effect; and
- "Other rebate systems where the grant of a financial incentive is not directly linked to a condition of exclusive or near-exclusive supply", which the court considered to be capable of being unlawful if, on a full analysis of all the circumstances, the scheme tends to exclude competitors or restrict the customer's freedom to choose his sources of supply.

The CMA's recent investigation concerned this third category of discounts/rebates, and its guidance focuses, in particular, on roll-back or retroactive discounts or rebates.

CMA Guidance

Roll-back or retroactive discounts are schemes that offer customers lower prices on units below as well as above that threshold on condition that a volume threshold is reached (also sometimes called retroactive discounts/rebates).

According to the CMA guidance, this type of scheme may be capable of inducing customer loyalty (and thus being unlawful) where the following three conditions are met:

- There are units that a customer has no choice but to buy from the dominant company (so-called "noncontestable sales");
- There are also units which the customer needs and which the customer may be willing and able to purchase either from the dominant company or from a competitor of the dominant company (so-called "contestable sales"); and
- The discount or rebate scheme targets the contestable sales—the customer will be entitled to a discount or rebate if it purchases units from the dominant company that it might otherwise have chosen to buy from a competitor.

The economic theory is that dominant firms are unavoidable trading partners such that their customers will always need to purchase a certain (high) percentage of their purchasing requirements for the relevant products or services from that firm. With respect to pharmaceuticals, this scenario is more likely to surface in connection with patented drugs or drugs coming off patent, that is, when a rapid erosion of sales is anticipated due to generic entry or the entry of drugs for which customers or doctors have a therapeutic preference.

The CMA has indicated that the three conditions set out in its guidance are not exhaustive and that it is also likely to intervene where the prices (after the discount or rebate) for

contestable sales are below average variable cost of production and the customer would be able to reduce its overall spending on the dominant company's products by increasing the volume of contestable sales.

The distinction between contestable and noncontestable sales and the use of average variable costs for the purpose of assessing the lawfulness of retroactive discounts and rebates are well accepted international antitrust standards, and they are relied upon by both the European Commission in its own 2009 Guidelines[4] and the U.S. antitrust agencies when assessing such practices. The CMA has adopted the approach taken by the European Commission in its guidelines which requires an economic assessment to be undertaken rather than the more formalistic approach adopted by earlier EU jurisprudence. For example, in *Tomra*,[5] the EU Court of Justice upheld an EU General Court's ruling and previous European Commission's decision that it was not necessary to calculate contestable and noncontestable sales in order to show that the retroactive rebate scheme in question was loyalty inducing and unlawful. The European Commission's Guidelines have superseded that approach, but this guidance is binding only on the European Commission itself, not also on national competition authorities (like the CMA) and courts. The fact that the CMA has explicitly said that it would apply a "contestability" test in future cases confirms that the CMA will nevertheless take the same approach as set out in the EU guidance. This is a useful indication to dominant companies in the UK that the CMA might consider the use of roll-back rebates and discounts to be permissible, provided that, on a proper economic analysis, their schemes do not make it more difficult for a competitor to compete for contestable sales.

A Warning?

On this occasion, the CMA decided to close the investigation and send a warning letter to the company under investigation and also issue general guidance for other companies. This may indicate that the CMA is concerned that the use of anticompetitive roll-back rebates or discounts is prevalent in the UK pharmaceutical or other sectors, and the CMA wishes to provide legal clarity in the expectation that businesses will assess and, if necessary, amend their current arrangements. In the future, if faced with a similar case again, it is likely the CMA then would take enforcement action. For example, in May 2015, the CMA found that an association of estate agents, three of its members and a local newspaper had breached competition rules by agreeing to restrict the advertising of fees and discounts in a local newspaper, despite the CMA's predecessor (the Office of Fair Trading) having previously warned these companies that such a practice could be anticompetitive. In that case, penalties were also imposed.

Fewer Decisions, More Guidance?

A common criticism of the CMA (and the Office of Fair Trading) is the lack of legal guidance or certainty on certain common business practices arising from the relative paucity of enforcement decisions and the resulting lack of precedents. In circumstances where the CMA seeks to manage its resources effectively by closing certain investigations on prioritization grounds rather than issuing decisions that would have precedential value, the CMA appears to be taking a two-fold approach:

- Focusing enforcement actions on cases that involve the most serious competition law breaches, present a reasonable prospect of being successfully prosecuted and would send a strong deterrence message; and
- Providing more guidance by way of general statements and warning letters in instances where there is a genuine concern about potentially anticompetitive practices, but not a sufficiently strong basis to bring an enforcement action either because of the lack of evidence or because of the de minimis nature of the markets concerned, or where there is just a lack of guidance or precedents.

Conclusion

The guidance provided by the CMA helpfully clarifies the economic test which the CMA will adopt in assessing under UK/EU competition rules retroactive discounts and rebates in the pharmaceutical sector. This economic approach appears to be consistent with established EU and U.S. antitrust approaches.

Although the CMA decided to close the case on prioritization grounds, it is likely that a failure to comply with this guidance by dominant companies using roll-back discounts or rebates carries a higher risk of further enforcement action by the CMA, should the arrangements come to the CMA's attention.

This case is of particular relevance for the pharmaceutical sector, although its implications go beyond the pharmaceutical sector and potentially reach out to all sectors where there is a company that is an unavoidable trading partner using retroactive discounts or rebates. Relevant businesses would therefore be well advised to assess and, if necessary, amend their current arrangements in compliance with the CMA's and other relevant EU guidance.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com/contactus/.

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Endnotes

1 Statement regarding the CMA's decision to close an investigation into a suspected breach of competition law in the pharmaceutical sector on the grounds of administrative priority.

2 In considering whether to pursue a complaint or start an investigation ex officio, the CMA will take into account not only the merits of the matter but also whether the matter falls within its priorities, *see* CMA Prioritization Principles (CMA 16).

3 Case T-286/09, *Intel v Commission* (June 12, 2014), currently under appeal.

4 European Commission Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct (2009/C45/02).

5 Case C-549/10 P *Tomra Systems v Commission*, paragraph 79.