

**Loyalty Discounts -
EU Law in Difficult Transition**

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Introduction

EU law on loyalty discounts is in a difficult transition period - with all ambiguities and uncertainties typical to transition. Its current status therefore is perhaps one of the least satisfactory areas of EU competition law.¹ Case law on loyalty discounts developed along formalistic lines relying on structural aspects and presumptions close to *per se* rules. Following intense controversy on the application of Article 102 TFEU (ex Article 82 EC), the EU Commission made an attempt to implement an effects-based approach. This attempt, however, is limited in various regards. It is, first of all, limited as to its legal nature. The Commission published a mere “Guidance” on its own enforcement priorities in applying Article 102 TFEU to abusive exclusionary conduct.² This Guidance is not a statement of law. The Commission wants it to be an attempt to place existing case law in a coherent analytical framework.³ The Commission had been expressly reminded that any re-orientation of its administrative practice on Article 102 TFEU will have to remain within the framework prescribed for this provision by the Court of Justice (CoJ).⁴ Other limitations apply to effects-based approach as such. Tests such as the “as efficient competitor test” are only part of a more general assessment in which the Commission wants to include other elements such as qualitative aspects.

The ambiguities of an effects-based approach within the framework of existing case law may best be illustrated by the Commission’s decision imposing a fine of more than €1 bn on Intel for alleged abuse of a dominant position.⁵ Relying on existing case law, the Commission had no difficulty to establish that purported fidelity rebates fulfilled the conditions for their qualification as abusive without any further need of establishing exclusionary effects.⁶ According to its own legal analysis, the Commission might have just stopped there. The decision, however, on top of showing

¹ Whish, *Competition Law*, 6th edition, 2009, p. 719.

² Communication from the Commission - Guidance on the Commission’s Enforcement Priorities in applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings, OJ C 45/7 of 24th February 2009 - hereinafter referred to as “Guidance” or “Guidance Paper”.

³ Peeperkon/Viertiö, *Competition Policy Newsletters* 2009-1, p. 1 of manuscript, available at http://ec.europa.eu/competition/publicatins/cpn/cpn_209_1.html.

⁴ Opinion of Advocate General Kokott, case C-95/04 P, *British Airways plc v Commission*, [2007] ECR I-2331, 2336, para 28.

⁵ Commission decision of 13.05.2009 relating to a proceeding under Article 82 of the EC Treaty and Article 54 of the EEA Agreement, COMP/C-3/37.990 Intel.

⁶ COMP/C-3/37.990 Intel, para 1001.

that the conditions of the case law for finding an abuse were fulfilled, conducted a lengthy economic analysis of the capability of the rebates practiced by Intel to foreclose a competitor which would be as efficient as Intel, albeit not dominant.⁷ As an enforcement agency, the Commission wants to win cases and therefore continues to rely on the form-based approach sufficient to satisfy the standards established by the CoJ. Only “in addition”, in order to show coherence with its own guidelines, the Commission wants to establish that the practice challenged also, under a more effects-based approach, is likely to produce exclusionary effects.

Despite all attempts by the Commission to establish some form of safe harbor in its Guidance, companies doing business in Europe cannot disregard the form-based approach of existing case law as eventually the Commission will rely on the same in order to win its cases. In addition, Article 102 TFEU is applied directly by national courts which are bound by the CoJ’s interpretation of Article 102 TFEU and, due to its very nature, will be reluctant to apply the Guidance offered by the Commission as an administrative body.

The present paper will therefore have to reflect the ambiguity between the CoJ’s form-based approach (section 2) and a more effects-based approach proposed by the Commission (section 3). Its final section will summarize the consequences of this double standard for companies likely to be dominant.

1. Loyalty discounts

Using the OECD’s definition, a loyalty discount is a lower price offered to customers buying more than a threshold volume.⁸ Details of loyalty discounts schemes vary, but their usual feature is a discount conditional upon the customer achieving a certain share or quantity of sales with the firm in question over a period that exceeds the normal purchase frequencies in the industry concerned. In order to obtain the discount, a customer may, for example, have to increase annual sales of the respective products by a quantity or percentage that is higher than what the customer achieved in the previous year with the firm granting the discount. The discount may apply either to purchases above the threshold or it may apply

⁷ Ibid., paras. 1002 et seq.

⁸ OECD round table „Bundled and Loyalty Discounts and Rebates“, DAF/COMP(2008) 29 of 02-Dec-2008, p. 7. In its Guidance, the Commission describes the usual nature of a conditional rebate to be a rebate given to the customer if its purchases over a defined reference period exceed a certain threshold; Guidance Paper para. 37.

to all the previous purchases too.⁹ Where the lower price applies to all sales, the discount is usually referred to as “retroactive” or “roll-back discount”.¹⁰

Loyalty discounts are a specific form of non-linear pricing. It is important to highlight that loyalty discounts are a wide spread commercial practice. They are common even among firms with no market power. In the view of most commentators, loyalty discounts usually reflect efficiencies and discounting is a key element of effective competition and therefore it is one of the practices that competition law and policy seek to promote.¹¹

2. The framework of existing EU case law - a formalistic approach to abuse

a) Prohibition of abuse of dominance in Article 102 TFEU

According to Article 102 TFEU (ex Article 82 EC), any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market insofar as it may effect trade between Member States. Article 102 TFEU does not prohibit dominance as such, but is aimed at controlling the abuse of exercise of market power.

The Court of Justice has defined a dominant position under Article 102 as

“... a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of consumers.”¹²

Generally, market share is used as an indicator of dominance. According to the *AKZO*-presumption, a stable market share of 50 % over at least three years is held to indicate a dominant position.¹³ In its Guidance Paper, the

⁹ O’Donoghue/Padilla, *The Law and Economics of Article 82 EC*, p. 374.

¹⁰ OECD round table, op. cit. p. 7; Guidance Paper para 37.

¹¹ OECD round table, op. cit. p. 7.

¹² Case 27/76 *United Brands v Commission* [1978] ECR 207, para 65.

¹³ Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, para 61.

Commission takes a more cautious approach to market shares but considers that low market shares are generally a good proxy for the absence of market power. It offers a soft safe harbor in stating that dominance is not likely if the undertaking's market share is below 40 % in the relevant market.¹⁴

The concept of abuse, according to the CoJ, is an objective one. Traditional analysis relies heavily on market structure. This is best illustrated in *Hoffmann-La Roche*:

“The concept of abuse is an objective concept relating to the behavior of an undertaking in a dominant position which is such as to influence the structure of the market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.”¹⁵

In the CoJ's jurisprudence, Article 102 TFEU imposes a “special responsibility” on dominant firms on account of the prejudice that their activities may cause to competition in general and the interest of competitors, suppliers, customers and consumers.¹⁶

Article 102 TFEU lists a number of examples for abusive behavior. They include limiting production, markets or technical development to the prejudice of consumers (Article 102 (2) (b) TFEU) or applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage (Article 82 (2) (c) TFEU). This list of examples is,

¹⁴ Guidance Paper para 14.

¹⁵ Case 85/76 - *Hoffmann-La Roche v Commission* [1979] ECR 461, para 91. As Bellami/Child, European Community Law of Competition, 6th edition 2008, para 10.060 indicate, this interpretation of “abuse” is now adopted as a standard formula, even where it is not obviously applicable.

¹⁶ Case 322/81 - *Michelin v Commission* [1983] ECR 3461, para. 57.

however, not exhaustive.¹⁷ The CoJ's jurisprudence as to loyalty discounts is not based on the examples listed, but based on Article 102 in its entirety.¹⁸

- b) The landmark case: *Hoffmann-La Roche v Commission* or the assimilation of loyalty rebates to single branding

The landmark case for EU law on loyalty rebates is the CoJ's judgment in *Hoffmann-La Roche v Commission*,¹⁹ a judgment on which the Commission continued to rely in its Intel decision of 13th May, 2009.²⁰ The judgment concerned discounts granted to undertakings whose business was the production or sale of vitamins and the grant of which was, for most of the time, expressly linked to the condition that the co-contractor obtained its supplies over a given period entirely or mainly from Hoffman-La Roche. The court found such discount system an abuse of a dominant position and ruled:

*“An undertaking which is in a dominant position on a market and ties purchases - even if it does so at their request - by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking abuses its dominant position within the meaning of Article 82 EC [now: 102 TFEU], whether the obligation in question is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate. The same applies if the said undertaking, without tying the purchases by a formal obligation, applies, either under the terms of agreements concluded with this purchases or unilaterally, a system of **fidelity rebates**, that is to say discounts conditional on the customer's obtaining all or most of its requirements - whether*

¹⁷ Case C-333/94 P - *Tetra Pak v Commission* [1996] ECR I-5951, para 37.

¹⁸ Case C-95/04 P - *British Airways plc v Commission* [2007] ECR, I-2331, para 58; Wish, Competition Law, 6th edition 2009, p. 720.

¹⁹ Case 85-76, *Hoffmann-La Roche v Commission* [1979] ECR 461.

²⁰ COMP/C-3/37.990 Intel, para 920. In addition, the decision quoted case C-95/04 p. - *British Airways v Commission* [2007] ECR 2331, para 62.

the quantity of its purchases be large or small - from the undertaking in a dominant position.”²¹

The passage quoted allows to draw three important conclusions. First of all, the prohibition of loyalty rebates is directly related to single branding arrangements. Behavior becomes abusive when the inducement caused by the promise of loyalty rebates to a customer to purchase all or most of its requirements from the dominant firms is so great that it has the **same effect** as a contractual stipulation to **purchase exclusively**.²²

Secondly, as *Wish* has rightly pointed out, the test formulated in *Hoffmann-La Roche* is expressed as a *per se* rule.²³

Thirdly, the standard imposed under *Hoffmann-La Roche* is particularly strict as the prohibition applies even if the quantity of the customer’s purchases is small.

- c) *Michelin I* or extending *Hoffmann-La Roche v Commission* to individualized target rebates

The standard set out in *Hoffmann-La Roche v Commission* was applied in *Michelin I*²⁴ to turnover related discounts, which are capable of operating with the same effects as fidelity rebates. In that case, the Dutch Michelin subsidiary offered its dealers an annual variable discount determined according to the dealer’s turnover in Michelin heavy vehicles, van and car tires in the previous year. The dealer received its discount, or the full rate thereof, only if it achieved an annual sales target fixed by Michelin. The CoJ upheld the Commission’s finding that Article 102 TFEU was infringed, saying that:

“Any system under which discounts are granted according to the quantities sold during a relatively long reference period has the inherent effect, at the end of that period, of increasing pressure on the buyer to reach the purchase figure needed to obtain

²¹ Case 85/76 - *Hoffmann-La Roche v Commission* [1979] ECR 461 para 89 - 90; emphasis added.

²² Wish, Competition Law, 6th edition 2009, p. 720.

²³ Wish, op. cit. p. 721.

²⁴ Case 322/81 - *NV Nederlandse Banden-Industrie Michelin v Commission* [1983] ECR 3461.

the discount or to avoid suffering the loss for the entire period."²⁵

The court found that the system was calculated to prevent dealers from being able to select freely, at any time in the light of the market situation, the most favorable of the offers made by the various companies and to change suppliers without suffering any appreciable economic disadvantage.²⁶

There is considerable uncertainty as to the impact of the reference period for target related discounts. In *Michelin I*, the court seems to suggest that only a relatively long reference period (of one year in this case) was able to trigger the fidelity-building effect of the discount scheme practiced by dominant firm Michelin. In *British Airways v Commission*²⁷ the duration of the reference period was not discussed. In a press release following the Commission's decision against British Airways, the Commission had indicated that the maximum admissible duration for discount systems in the air transport sector was six month.²⁸ In *British Airways v Commission* advocate general Kokott argued a case by case approach to reference periods. She emphasized that the longer the reference period lasts, the greater the uncertainty as to the achievement of the bonus will be at the end of the period. On the other hand, she did not want to exclude the possibility that even a system in which reference is made month by month to periods lying one year back, on account of the continual incentive it gives to increase turnover, result in a long-term binding making it harder for the contractual partners to switch to a competitor.²⁹

25 Ibid, para 81.

26 Ibid, para 85.

27 Case C-95/04 [2007] ECR 2331.

28 Finnigan, Commission sets out its policy on commissions paid by airlines to travel agents, Competition Policy News Letter 1999-3, 23.

29 Opinion of advocate general Kokott in case C-95/04 P, *British Airways plc. v Commission* [2007] ECR 2331, 2336, para 94.

- d) The standard of foreclosure effect according to the *British Airways* case

In *British Airways v Commission*,³⁰ sometimes referred to as “British Airways/Virgin”, the CoJ set out the standard to assess “goal-related discounts”, comprising both loyalty discounts and individualized target rebates, practiced by dominant undertakings. The court reaffirmed his jurisprudence in reply to numerous claims by the plaintiff British Airways that the Commission was about to modify its approach to exclusionary practices under Article 102 TFEU. Advocate general *Kokott*, in her opinion expressly relied upon by the court, addressed the Commission’s intention to re-define its policy on ex-article 82. In the context of the case it was, she said, “immaterial how the Commission intends to define its competition policy with regard to Article 82 EC for the future”.³¹ Advocate general *Kokott* expressly stated that even if the Commission’s administrative practice was to change, the Commission would still have to act **within the framework prescribed** for it by Article 82 EC as interpreted by the Court of Justice.³²

British Airways (BA), the largest UK airline, concluded agreements with travel agents in the UK including systems of financial incentives. The level of commission payable increased as a new target was reached and the increased amount was payable on all the tickets sold, not just on the incremental sales above the target. The Commission imposed a fine of €6.8 million on BA for infringement of Article 82 EC. The Court of First Instance upheld the decision and BA appealed to the Court of Justice.

The CoJ expressly confirmed the *Hoffmann-La Roche* standard and distinguishes **three types of discounts** or bonuses:

- (1) pure quantity discounts or bonuses

³⁰ Case C-95/04 P - *British Airways plc v Commission* [2007] ECR I-2331.

³¹ Case C-95/04 P - *British Airways plc v Commission* [2007] ECR I-2331, para 28 of the Opinion.

³² *Ibid.*

- (2) loyalty discounts or bonuses within the meaning of the judgment in *Hoffmann-La Roche* and
- (3) other bonuses practiced by undertakings in a dominant position, in particular target related discounts.

As to (pure) quantity discounts, they always constituted the example given for legitimate discounts or rebates even by dominant firms.³³ For loyalty discounts, the CoJ continues to apply the *Hoffmann-La Roche* standard. For other discounts practiced by dominant undertakings, qualified as **goal-related** discounts, the court establishes a two tier test. If practiced by dominant undertakings, these discounts are abusive if (i) they have **exclusionary effects** and (ii) they lack **objective economic justification**.

Exclusionary effects of goal-related discounts, according to the court, may be based on their capability to either make market entry “very difficult” or their capability of producing a **fidelity building effect**. The *British Airways* judgment does not address questions of market entry but deals exclusively with possible fidelity building effects of BA’s incentives scheme.

The exclusionary effect of BA’s scheme was essentially based on the character as roll-back discount. Attainment of the sales progression objectives gave rise to an increase in the commission paid on all BA tickets sold by the travel agent concerned and not just on those sold incrementally after the objectives had been obtained.³⁴

The CoJ relies on the CFI’s analysis that “the progressive nature of the increased Commission rates had a very noticeable effect at the margin” and on the “radical effects which a small reduction in sales of BA tickets could have on the rates of performance-related bonus”. For the court, a qualitative statement of strong pressure in the case of roll-back bonuses was sufficient to conclude on exclusionary effects. In addition, but on a mere qualitative basis, it

³³ In *Hoffmann-La Roche v Commission* it was accepted that quantity discounts linked solely to the volume of purchases fixed objectively and applicable to all purchases, would be permissible; case 85/76 [1979] ECR 461, para 90.

³⁴ Para 74.

confirmed that competitors would have to offer significantly higher rates of discounts in order to receive a sufficient volume of orders from co-contractors, and referred to the dominant undertaking as *per se* unavoidable trading partner.

It is not entirely clear to which extent the CoJ would accept a defense that competitors of the dominant firms were able to offer a similar discount scheme.³⁵

Although the CoJ formulates a standard of exclusionary effects of goal-related discounts, this should not be confounded with an “effects-based approach” to Article 102 TFEU. All “effects” analyzed by the CoJ are attributed to the structure of the discounts offered in a qualitative way. In the CoJ’s view, it seems sufficient that a roll-back discount related to sales targets produces strong effects at the margin (which is inherent to such concepts) to conclude on its exclusionary effects.

At the second tier, the CoJ discusses possible **objective economic justifications** of the discount scheme. It emphasizes that only discounts or bonuses which are not based on any economic counterpart to justify them are abusive. The type of analysis proposed by the court is similar to the efficiency-exception under Article 101 (3) TFEU. It has to be determined whether the exclusionary effect arising from the discount scheme may be counterbalanced or outweighed by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of the system bears no relation to advantages for the market and consumers, or if it goes beyond what is necessary in order to attain those advantages, that system must be regarded as an abuse.³⁶

Although Article 102 TFEU does not provide for an express “efficiency defense”, the court’s jurisprudence reads the concept of abuse to require a lack of objective economic justification.

³⁵ The CoJ held that BA’s plea that the rival airlines had been able to establish a similar reward scheme was inadmissible as it was not limited to questions of law.

³⁶ Judgment para 86.

e) Concluding remarks on current case law

The CoJ's approach to loyalty discounts follows formalistic lines. It is based on the idea of a special responsibility of dominant undertakings for the remaining competition and for the structure of competition in particular. Loyalty discounts are almost subject to a *per se* prohibition. The "efficiency defense" available requires counter balancing efficiencies which also benefit the consumer and which do not go beyond what is strictly necessary.

Discounts granted by a dominant undertaking seem to be justified only when they are conditioned on the achievement of standardized turnover thresholds and reflect cost savings.³⁷ Target related discounts, in particular in form of a roll-back discount, inevitably produce suction effects based on last units and thereby, under the CoJ's approach, inherently have a fidelity building effect. The CoJ's jurisprudence, in addition, leaves open to which target related rebates can also be challenged as discriminatory under Article 102 TFEU.

3. Effects-based approach under the Commission's Guidance

a) A more economic approach to exclusionary abuses

The Commission's Guidance on its enforcement priorities in applying Article 82 EC (now: Article 102 TFEU) to abusive exclusionary conduct by dominant undertakings is an intermediary result of a larger attempt to modernize the application of this provision. Some of the guiding principles of the Commission's own reflection on the policy underlying Article 102 TFEU had been set out by Commissioner Neelie Kroes at the 2005 Fordham Corporate Law Institute. Commissioner Kroes drew a parallel to the US debate on enforcement of Section 2 of the Sherman Act and formulated her own philosophy in a way which most likely was sympathetic to an American audience:

"My own philosophy on this is fairly simple. First, it is competition, and not competitors, that is to be protected. Second, ultimately the aim is to avoid

³⁷ Faella, *The Antitrust Assessment of Loyalty Discounts and Rebates*, p. 14.

consumers harm. I like aggressive competition - including by dominant companies - and I do not care if it may hurt competitors - as long as it ultimately benefits consumers. That is because the main and ultimate objective of Article 82 is to protect consumers, and this does, of course, require the protection of an undistorted competitive process on the market."³⁸

In 2005 the Commission published a Staff Discussion Paper on the application of Article 82 of the Treaty to exclusionary abuses by dominant undertakings³⁹ which stimulated a broad debate with all stakeholders. The Commission perceived its reflection as part of a "more economic approach" of European competition policy which aims at stricter consumer harm standard in competition policy. The application of Article 102 TFEU was, in the Commission's own view, too concerned with "fairness" and not sufficiently focused on consumers.

The Staff Discussion Paper on the application of Article 82 initially pursued a much broader policy to set out principles for the Commission's application of Article 102 TFEU to exclusionary abuses. The Guidance eventually published by the Commission has a more limited role. At least formally it does not claim to be a statement of the law and is limited to formulating enforcement priorities of the Commission. It is, on the other hand, apparent that the Commission has difficulties to reconcile the existing case law with the "coherent analytical framework" it wants to pursue in applying Article 102 TFEU. The Guidance therefore is not only orientation on enforcement priorities - after all, enforcement of Article 102 TFEU by the Commission has been very limited. The Guidance is perceived as a more formalized attempt by the Commission to influence both, the jurisprudence of the European courts and enforcement in Member States to adopt some form of consumer welfare standard. So far, the CoJ showed little sympathy to these

³⁸ Neelie Kroes, Preliminary Thoughts on Policy Review of Article 82, speech at the Fordham Corporate Law Institute, New York, 23rd September 2005, available at <http://ec.europa.eu/competition/antitrust/art82/index.html>.

³⁹ Available at <http://ec.europa.eu/competition/antitrust/art82/index.html>.

appeals. In *France Telekom SA v Commission*⁴⁰ plaintiff France Telekom argued a modern consumer welfare standard to predatory practices. The CoJ replied by expressly restating its most traditional jurisprudence on Article 102 TFEU (then Article 82 EC) and said:

“Therefore, since Article 82 EC refers not only to practices which may cause damage to consumers directly, but also to those which are detrimental to them through their impact on an effective competition structure (case 6/72 Europeemballage and Continental Can v Commission [1973] ECR 215 paragraph 26), an undertaking which holds a dominant position has a special responsibility not to allow its behavior to impair genuine undistorted competition on the Common Market (Nederlandse Banden-Industrie Michelin v Commission, paragraph 57).”⁴¹

Despite the claim to put harm to consumers into the focus of enforcement of Article 102 TFEU, attempts to identify likely consumer harm in a direct manner appear largely absent in the Guidance Paper. The Commission identifies a total of seven factors which should allow to identify anti-competitive foreclosure, but none of these are directly about consumer harm. The general assumption seems to be that foreclosure is just assumed to cause consumer harm.⁴²

b) General approach of the Guidance

Similar to the existing case law, the Guidance sets out a two-step approach to assessing allegedly abusive exclusionary conduct by dominant undertakings. The first step is an assessment to which extent the conduct in question is likely to lead to anti-competitive **foreclosure**. The second step consists in analyzing whether any **efficiency defenses** by the dominant undertaking are such as to outweigh the identified negative effects of the

⁴⁰ Case C-202/07 P, *France Telekom SA v Commission*, not yet reported.

⁴¹ *Ibid*, para 105.

⁴² Cf. the general critic by Monti, Article 82 EC: What future for the effects-based approach? JECLAP 2010, 2, 3.

conduct. This second step is fully coherent with the case law as described above.

Assessing likely anti-competitive foreclosure is described to be a more complex analysis. The Commission wants to consider a total of 7 factors (so-called “paragraph 20 factors”)⁴³ together with more specific factors described in the sections dealing with certain types of exclusionary conduct, such as exclusive dealing or predation. The Commission, however, reserves the right to include “any other factors which it may consider to be appropriate”. The Commission even envisages circumstances in which no detailed assessment is necessary to conclude that the conduct in question is likely to result in consumer harm. Apparently, in order to facilitate enforcement, it may as well rely on *per se* rules in the established, more form-based jurisprudence.

For the various types of price-based exclusionary conduct, the Commission intends to follow an **as efficient competitor-test**. The Commission will

“normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking.”⁴⁴

c) As efficient competitor test with respect to loyalty rebates

The Commission assesses loyalty rebates as a particular form of conditional rebates which are perceived as common practice but tainted with ambiguity if practiced by dominant undertakings. The Commission will apply its as efficient competitor test and intends to investigate whether the discount system is capable of hindering expansion or entry even by competitors that are equally efficient by making it more difficult for them to supply part of the requirements of individual customers.

⁴³ Guidance Paper, para 20.

⁴⁴ Guidance Paper para 23. Surprisingly, the Commission finds some support for this test even in the elder case law and refers to case 62/86 *Akzo Chemie v Commission* [1991] ECR I-3359 para 72.

The key question is whether equally efficient competitors are able to compete with the **effective price** resulting from the application of the rebate scheme of the dominant undertaking. In order to motivate a customer to switch part of his demand away from the dominant undertaking, a competitor will have to offer a price compensating the customer for the loss of the conditional rebate. The effective price that the competitor will have to match is not the average price of the dominant undertaking but the normal (list) price less the discount the customer loses by switching, calculated over the relevant range of sales and in the relevant period of time. What is the relevant range depends on the character of the discount.

For **incremental rebates**, the relevant range is normally the incremental purchases that are considered.

For **roll-back discounts** the relevant range is the contestable share, i.e. the share of a customer's purchase requirements which can realistically be switched to a competitor.

Typically, dominant undertakings will hold a substantial power over a significant part of the customers' demand which is referred to as the assured base of sales. This normally results in competitors being unable to compete for the entire requirement of individual buyers. Dominant undertakings are thus typically able to leverage their assured base of sales into the contestable share.

The Commission proposes to estimate the contestable share for existing competitors by looking at their capacity to expand sales to customers and the fluctuations in those sales over time. For potential competitors, it may be possible to take the historical growth pattern of new entrants in the same or in similar markets as an indication of a realistic market share of a new entrant.

The relevant range is small if customers are willing or able to switch only small amounts of their demand. Attributing the discount lost as a result of switching demand to this small relevant range will result in very low effective prices. Conversely, if customers are prepared to switch larger

amounts, the lost rebate is attributed to a larger amount of sales and will result in higher effective prices.

Whether or not the roll-back discount is exclusionary, will be determined in **comparing the effective price to the cost of the dominant supplier**. As long as the effective price remains consistently above the LRAIC (long-run average incremental costs)⁴⁵ of the dominant undertaking, this would normally allow an equally efficient competitor to compete profitably notwithstanding the discount.

On the other hand, even competitors as efficient as the dominant undertaking are foreclosed if the effective price is below AAC (average avoidable costs)⁴⁶ of the dominant undertaking.

If the effective price is above AAC but still below LRAIC, the Commission will look at counter strategies at the disposal of competitors. If competitors do not have “realistic and effective counter strategies at their disposal”, the Commission will consider the rebate scheme producing an effective price below LRAIC to be capable of foreclosing equally efficient competitors.

The appropriate cost measure for loyalty discounts and for predation in general is one of the most disputed subjects. The Commission, in proposing LRAIC of the dominant firm, opted for a more prudential approach. This is justified by the nature of this test as a “soft safe harbor”. Relying on the costs of the dominant firm, at least in theory, allows self-assessment by firms likely to enjoy market power in order to avoid discount schemes leading to foreclosure. On the other hand, as these costs are unlikely to be known to competitors or customers, the test is tailored to the application by an enforcement agency.

The test proposed contains no specific rules on reference periods for loyalty discounts. This is understandable as

⁴⁵ Long-run average incremental costs is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC and average total cost (ATC) are good proxies for each other, and are the same in the case of single product undertaking; cf. Guidance Paper, p. 11, footnote 2.

⁴⁶ Average avoidable costs is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case the amount allegedly the subject of abusive conduct. In most In most cases, AAC and the average variable costs (AVC) will be the same, as it is often only variable costs that can be avoided; cf. Guidance Paper, p. 11, footnote 2.

duration of the reference period is not a reliable indicator of possible exclusionary effects. It therefore seems justified to look primarily at contestable parts of customers' demand. However, given the importance attributed to the duration of the reference period in past practice, the Commission's silence will only further increase the uncertainties perceived by firms likely to be dominant.

4. Living with a double standard

Whereas the Commission's Guidance is formally restricted to its own enforcement priorities, it nevertheless shows attempts to offer more legal certainty to companies likely to be dominant. This applies to the soft safe harbor offered with respect to dominance if the undertaking's market share is below 40 % in the relevant market.⁴⁷ More specifically with respect to loyalty rebates, the same is true for the statement that a conditional rebate is normally not capable of foreclosing in an anti-competitive way as long as the effective price remains consistently above the long-run average incremental cost (LRAIC) of the dominant undertaking.⁴⁸

These indications are, however, of very limited value. The Commission not only reserved the possibility to find dominance below a 40 % market share but qualifies its entire as efficient competitor test as being only part of an overall assessment under the "paragraph 20 factors" which include evidence of actual foreclosure or "smoking gun" evidence of exclusionary strategies. In addition, the Commission expressly indicates that it may rely on *per se* rules if it appears that the conduct "can only raise obstacles to competition and that it creates no efficiencies".

As a result of these qualifications, companies which are likely to hold a dominant position enjoy very little legal certainty even with respect to enforcement measures by the Commission itself. This uncertainty is even greater with respect to all situations in which Article 102 TFEU may be invoked by competitors, trading partners or national enforcement agencies. National courts may consider the Commission's Guidance, but are certainly bound by the interpretation of Article 102 TFEU given by the CoJ.

⁴⁷ Guidance Paper, para 14.

⁴⁸ Guidance Paper, para 43.

The court's case law sets a second and largely different standard for the assessment of loyalty or target related discounts. Fidelity building effects seem to be almost inevitably in case of roll-back discounts which inevitably produce "very noticeable effects at the margin". This "effect" will normally be correlated with some part of the demand being non-contestable due to the dominant undertaking's position as typically unavoidable trading partner. These two elements, in the light of *British Airways v Commission*, are sufficient to qualify discounts as exclusionary.

The possibility to claim objective economic justification which would exclude the abusive character of an exclusionary bonus seems largely theoretical. The existing case law shows no examples of objective justification outside the area of pure quantitative rebates. In *British Airways v Commission* the Court of First Instance expressly rejected the argument that the high level of fixed costs in air transport and the importance of aircraft occupancy rates justified the incentive schemes.⁴⁹

Under these circumstances, it is at best lip service if advocate general *Kokott* claims that the CoJ's approach ensures that no rebates or bonuses are caught which could be regarded as part of legitimate price competition on the relevant market.⁵⁰ In reality, the difference to the perception that loyalty discounts are most often pro competitive⁵¹ could hardly be greater.

⁴⁹ Case T-219/99 - *British Airways v Commission* [2003] ECR II-5917, para 294, 295.

⁵⁰ Opinion of advocat general *Kokott* in case C-95/04 [2007] ECR 2331, 2336, para 45.

⁵¹ United States contribution to OECD, round table on bundled and loyalty discounts and rebates of 10th June 2008, DAF/COMP/WP3/wd(2008)47, para 38.