Draft report prepared for the 2021 Annual Conference of the GCLC
Please do not cite w/o approval

# Conditional Rebates under EU Competition Law:

## A retrospective on *Michelin I, Michelin II* and *BA/Virgin*


**Christian Ahlborn, Linklaters LLP**

**Xavier Boutin, Positive Competition**

**Verity Egerton-Doyle, Linklaters LLP**

**Nayantara Ravichandran, Linklaters LLP**



The authors acknowledge and thank the members of their 2021 GCLC conference working group for their contributions: Lars Kjolbye, Damien Neven, Claire Simpson and Denis Waelbroeck. We also thank Jean-François Bellis and Nicolas Petit for their comments. Finally, we are grateful to our colleagues, Dasha Konnova and Benjamin Sidbury for their help with this paper. Needless to say, any remaining errors are the authors' alone.

# Table of Contents

# I. INTRODUCTION

This paper is part of a wider project on the *ex post* assessment of landmark competition cases for discussion at the 2021 GCLC conference. It focusses on three of the key cases in the evolution of European Union ("**EU**") law on the treatment of conditional rebates[1] under Article 102 of the Treaty on the Functioning of the European Union ("**TFEU**") ("**Article 102 TFEU**") and its precursors (Article 82 and Article 86 of the Treaty Establishing the European Community):[2] *Michelin I*,[3] *Michelin II*,[4] and *BA/Virgin*[5] (our "**Focus Cases**"). The objective of this paper is to consider how these three significant cases should be viewed with the benefit of over 20 years of hindsight and in light of more recent developments in case law and economic literature.

More specifically, the authors have reviewed the legal and economic framework applied in each case and considered whether the approach taken was the correct one; both at the time and with the benefit of hindsight of further developments in legal and economic thought. The remainder of the paper is structured as follows. **Section II** briefly summarises each Focus Case. **Section III** provides a general framework for analysis of conditional rebates outlining: (i) their classification; (ii) the economic framework for analysis; and (iii) the legal framework for analysis and the object / effect distinction as a framework for understanding treatment of rebates under Article 102 TFEU; and (iv) the economic building blocks for an effects-based analysis. **Section IV** describes the Focus Cases in depth, looking at: (i) the conduct under consideration; (ii) the legal test applied, (iii) the theories of harm; and (iv) the evidence considered. **Section V** evaluates the approach taken in the Focus Cases and considers: (i) whether the right framework and theories of harm were applied; (ii) whether, on the basis of the evidence, the Focus Cases reached appropriate conclusions; (iii) their internal consistency; and (iv) whether important relevant facts have been considered. **Section VI** concludes.

[1] The terms "discount" and "rebate" refer to different forms of discounting practices, which can have different or similar effects on the incentives of purchasers depending on the market context. It is common to refer to "discounts" as conditional price reductions typically paid upfront while "rebates" are paid once the condition has been fulfilled (they could also be paid upfront on the assumption that they will be repaid if the condition is not met). In this paper, we refer to the latter when we use the term "conditional rebates".

[2] All references to Article 102 in this paper should be understood as a reference to the equivalent provision in force at the time.

[3] Case C-322/81, *Nederlandsche Banden Industrie Michelin NV v Commission of the European Communities* EU:C:1983:313 ("***Michelin I***").

[4] Case T-203/01, *Manufacture Française des Pneumatiques Michelin v Commission of the European Communities* EU:T:2003:250 ("***Michelin II***").

[5] Case C-95/04 P, *British Airways Plc v Commission of the European Communities* EU:C:2007:166 ("***BA/Virgin***").

## II. THE FOCUS CASES – IN A NUTSHELL

### A. *Michelin I*

*Michelin I* concerned a system of rebates applied by Nederlandsche Banden-Industrie Michelin ("**Michelin NV**") between 1975 and 1980. The EC issued its decision on 7 October 1981,[6] which Michelin NV subsequently appealed to the European Court of Justice ("**ECJ**"). The ECJ issued its judgment on 9 November 1983.[7] The case arose following a complaint from an association of tyre dealers.[8]

Michelin NV was found to have held a dominant position in the market for replacement tyres for trucks and buses in the Netherlands. It offered various rebates to dealers, each linked to increasing the number of purchases from Michelin NV either explicitly or through the setting of targets (so-called target rebates).

The impugned rebates were often informally negotiated with dealers without written confirmation. In particular, Michelin NV offered a bonus to individual dealers who purchased a target volume of tyres. The target increased year on year. Michelin NV's internal documentation showed a large degree of variation in the rebates and bonuses that Michelin NV paid to its dealers.

The European Commission ("**EC**") condemned these practices as abusive. It considered that Michelin NV's conduct restricted the dealers' freedom of choice and resulted in inequality of treatment between tyre dealers.[9] The EC imposed a fine of EUR 0.68 million. The ECJ agreed that Michelin NV's practices were abusive and tended to bind the dealers to Michelin NV by virtue of the uncertainty of the arrangements.[10] It reasoned that Michelin NV's rebate system was calculated to prevent dealers from being able to select the most favourable of the offers made by the various competitors freely at any time and to change suppliers without suffering any appreciable economic disadvantage.[11] The fine was reduced to EUR 0.3 million by the ECJ on appeal.

### B. *BA/Virgin*

On 14 July 1999, the EC issued an infringement decision against British Airways ("**BA**") in relation to commissions that BA offered to travel agents.[12] The case arose following a complaint made by Virgin Atlantic ("**Virgin**"). BA appealed the EC's decision to the Court of First Instance ("**CFI**")[13] and later the ECJ, but both appeals were dismissed, on 17 December 2003,[14] and 15 March 2007[15] respectively.

The rebate schemes under scrutiny comprised (as in *Michelin I*) of target rebates (i.e. retrospective payments that travel agents could earn based upon increasing their sales of BA tickets compared to the previous year, quarter and month). The EC found that the schemes were abusive in two ways.

---

[6] Case 81/969/EEC, *Bandengroothandel Frieschebrug BV/NV Nederlandsche Banden-Industrie Michelin*, 7 October 1981 ("***Michelin I (EC)***").

[7] *Michelin I*.

[8] *Michelin I*, page 3467.

[9] *Michelin I (EC)*, para. 37.

[10] *Michelin I,* para. 86.

[11] *Michelin I*, para. 85.

[12] Case IV/D-2/34.780, *Virgin/British Airways*, 14 July 1999 ("***BA/Virgin (EC)***").

[13] The CFI later became the General Court. In this paper, we use the name at the relevant time.

[14] Case T-219/99, *British Airways Plc v Commission of the European Communities* EU:T:2003:343 ("***BA/Virgin (CFI)***").

[15] *BA/Virgin*.

First, they rewarded and encouraged the loyalty of travel agents for selling and increasing their sales of BA tickets.[16] This restricted the freedom of agents to sell their services to the airlines of their choice and hindered the access of competing airlines to the UK market for air travel agency services.[17] Second, the schemes were held to be discriminatory since, contrary to Article 102 TFEU, they had the effect of imposing dissimilar conditions to equivalent transactions on the agents in question.[18]

The EC also synthesised the case law from *Hoffmann-La Roche*[19] and *Michelin I* to establish a general principle that a dominant company can give rebates that relate to efficiencies (e.g. on large orders) but not those that encourage loyalties (i.e. for avoiding purchases from the dominant supplier's competitor).[20] The EC fined BA EUR 6.8 million, which was upheld on appeal.

## C. *Michelin II*

Twenty years after its *Michelin I* decision, on 20 June 2001, the EC issued a second decision against Michelin – this time relating to a complex system of rebates, discounts and financial benefits offered by Manufacture Française de Pneumatiques Michelin ("**Michelin France**") for a period of 19 years, starting in 1980 (soon after the end of the Michelin NV rebate system).[21] Again, the EC's investigation followed a complaint by one of Michelin France's competitors – Bandag.[22] Like *Michelin I*, the scheme of rebates was offered to dealers in new replacement tyres and re-treaded tyres, but this time in France. Michelin France subsequently sought the annulment of the EC's decision in the CFI. The CFI upheld the EC's decision on 30 September 2003.[23] There was no further appeal to the ECJ.

The EC scrutinised a number of different schemes administered by Michelin France, which were again linked to increasing purchases. The various schemes entered into were retroactive volume rebates with a reference period of one year. The quantity rebate was calculated on the basis of all sales made during the reference period rather than the incremental sales.[24] These schemes, which had previously been considered lawful, were considered by the EC to be loyalty-inducing and to place Michelin France's dealers in a position of dependence, whilst simultaneously foreclosing competing tyre manufacturers.

The EC fined Michelin France EUR 19.76 million and ordered Michelin France to refrain from repeating any of the abusive conduct or from adopting any measure having equivalent effect. This finding was upheld on appeal.

---

[16] *BA/Virgin (EC)*, para. 102.

[17] *BA/Virgin (EC)*, para. 102.

[18] *BA/Virgin (EC)*, para. 107.

[19] Case C-85/76, *F Hoffmann-La Roche & Co AG v Commission of the European Communities* EU:C:1979:36 ("***Hoffmann-La Roche***").

[20] *BA/Virgin (EC)*, para. 101.

[21] Case COMP/E-2/36.041/PO, *Michelin,* 20 June 2001 ("***Michelin II (EC)***").

[22] The complaint came in the context of a broader trade dispute between Michelin, Bridgestone / Firestone Inc. and Bandag, which included litigation in the US: for more detail see, Appel, "Michelin Units Add Firestone to Lawsuit Against Bandag", *Wall Street Journal*, published on 1 February 2001, available at <https://www.wsj.com/articles/SB981039581655735863>.

[23] *Michelin II*.

[24] *Michelin II*, paras. 218 and 224.

# III. GENERAL FRAMEWORK – PUTTING THE FOCUS CASES IN CONTEXT

This section provides some of the necessary context for the detailed description and in-depth analysis of the Focus Cases that follows in **Sections IV** and **V**. **Section III.A** outlines the various kinds of conditional rebates, highlighting those that were considered in the Focus Cases. **Section III.B** considers the economic aspects of conditional rebates, namely the main theories of harm and efficiencies associated with conditional rebates. **Section III.C** gives an overview of the framework for analysing the legal treatment of rebates under Article 102 TFEU, based upon the possible distinction between "by object" and "by effect" abuses. Finally, **Section III.D** shows how these economic considerations can be used as a basis for building blocks for legal tests.

## A. Types of conditional rebates

### 1 Scope

The Focus Cases – and thus this paper – consider "*pricing structures offering lower prices in return for a buyer's agreed or de facto commitment to source a large and/or increasing share of his requirements from the discounter*".[25] In other words, rebates refer to forms of non-linear pricing which are dependent on the customer meeting certain conditions, and we refer to them generally as "conditional rebates".

It is also important to outline what is *not* within the scope of this paper. First, this paper focuses on single-product rebates only and does *not* consider multi-product rebates, which generally fall under a bundling analysis (we note that in *Michelin I* bundling rebates are briefly considered and then dismissed). Second, since the Focus Cases consider pricing abuses, this paper does not deal with related non-pricing abuses except to the extent relevant in evaluating the approach taken in the Focus Cases. In particular, rebates, even those offered with the aim or explicit objective of generating customer fidelity, must be distinguished from contractual exclusivity (i.e. agreements to purchase exclusively from the supplier as a *condition* of sale). While rebates can have exclusivity-inducing effects, the two must be assessed separately, because contractual exclusivity *guarantees* exclusivity (unless the contract is breached) in a way that a rebate does not.[26] Contractual exclusivity is therefore outside the scope of this paper.

Following the Focus Cases, as well as other cases considering rebates, four broad "kinds" of categories of rebates have emerged. Despite the limitations of a strict taxonomy from both a legal and economic perspective,[27] employing this broader classification of rebates may help in identifying a scale of competition concerns. We outline these and consider how they can be seen to have developed through the Focus Cases, as a useful framework for our analysis in **Section V** below.

[25] Loyalty and Fidelity Discounts and Rebates, OECD Report, 4 February 23 (DAFFE/COMP (2002), 21), page 7.

[26] For more on the distinction between "exclusivity obligations" and "exclusivity options" and its relevance to assessment of different restraints, see: Petit, "Intel, leveraging rebates and the goals of Article 102 TFEU", *European Competition Journal,* 11(1), pp. 26-68 (2015).

[27] O'Donoghue & Padilla, "Law and Economics of Article 102 TFEU", page 1174 (2020).

# 2 Classification

## 2.1 Rebates (explicitly) linked to exclusive or near-exclusive dealing

Under such a rebate, a purchaser is given a discount on the condition of obtaining all or most of its requirements from the dominant firm: the rationale for competition concerns is that such rebates may have a similar competitive effect to a contractual exclusivity obligation. This was first considered in *Hoffmann-La Roche* (where it was considered unlawful).[28] The rationale for this rule, and the precise bounds of what can be considered to fit into this category, is one of the key controversies in the case law on rebates over the past 40 years.[29] Notwithstanding this controversy, the principle that rebates explicitly conditioned on exclusive or near-exclusive dealing are presumed to constitute an abuse (albeit that if the dominant firm seeks to rebut this presumption, the burden shifts to the EC to establish an anticompetitive effect) remains part of the law at the time of writing.[30] This will be discussed at length in this paper.

A common feature of the Focus Cases is that none of the rebate systems considered impose an explicit exclusivity commitment. But in all the Focus Cases, the various systems of rebates were considered (in some cases, cumulatively) to be fidelity-inducing, and thus prohibited under Article 102 TFEU. In particular, in both *Michelin* cases, there was a focus on the complexity and opacity of the rebate schemes, meaning that dealers felt compelled to purchase all or most of their requirements from Michelin. It is arguable that the features of the Michelin Friends Club considered in *Michelin II* were capable of promoting near-exclusive dealing, but the EC (endorsed by the CFI) considered the Michelin Friends Club cumulatively with the other rebates offered by Michelin France.

## 2.2 Target rebates

Under a target rebate system, a purchaser is granted a retroactive rebate, i.e. a rebate across all units purchased during the reference period once a certain condition (generally a purchase volume condition) is met. Target rebates (as we refer to them in this paper) are set individually. The objection to this form of rebate is that it can generate strong incentives for the purchase of incremental volumes and can have foreclosure effects if it makes it difficult for competitors to match the effective price.[31] Such an effect can be observed where a certain portion of a purchaser's demand is captive to the dominant supplier (i.e. non-contestable), which prevents competitors, even competitors that are as efficient in all other ways, from profitably serving the contestable segment of demand. However, such effect does not necessarily hold true in all circumstances, as described further below. *Michelin I* and *BA/Virgin* most neatly fit into this category.

Most cases dealing with target rebates have considered schemes where the purchase volumes that needed to be achieved were growth targets from one period to the next (though the category also includes individualised volume rebates that do not represent growth targets). Historically, the EU courts took a cautious approach to the circumstances in which individualised target rebates could be considered unlawful. In *Michelin I*, it was considered that the opacity of the system meant that

---

[28] *Hoffmann-La Roche*, para. 89.

[29] Case T-155/06, *Tomra* EU:C:2012:221 ("***Tomra***"); Case C-413/14 P *Intel Corp Inc v European Commission* EU:C:2017:632 ("***Intel***"); see also the extensive writings on this topic, for example: Geradin, "Loyalty Rebates after Intel: Time for the European Court of Justice to Overrule Hoffman-La Roche" *Journal of Competition Law & Economics,* George Mason Law & Economics Research Paper No. 15-15 (2015); Neven, "A structured assessment of rebates contingent on exclusivity", *Competition Law & Policy Debate,* 1(1), pp. 86-96 (2015); Colomo, "Intel and Article 102 TFEU Case Law: Making Sense of a Perpetual Controversy", LSE Law, Society and Economy Working Papers 29/2014; Petit, "Intel, leveraging rebates and the goals of Article 102 TFEU", *European Competition Journal,* 11(1), pp. 26-68 (2015).

[30] *Intel*, paras. 137-139.

[31] O'Donoghue & Padilla, page 1196.

dealers would not know the actual amount of the rebate (and consequently the effective price per unit) until the end of the period. Given this uncertainty, it was considered that dealers would be averse to buying from other suppliers since this could risk not achieving the target threshold. However, the EC did not assess qualitatively or quantitatively the likely effect of the rebates on customers' behaviour, and in particular, the materiality of the customers' loss aversion that would justify such a conclusion.

The approach to target rebates grew more hostile as the EC and the EU courts seemed prepared to assume anticompetitive effects (and therefore presume illegality) without any detailed analysis. In *BA/Virgin*, while the nominal percentage of the discounts offered by the rebates was quite low, the EC highlighted that BA's large sale base meant that in practice the rebates resulted in large monetary benefits for dealers.[32] The progressive nature of the system meant that rebates were capable of rising exponentially from one reference period to another, with the risk of a disproportionate decrease if sales declined even slightly.[33]

In some respects, *BA/Virgin* can be viewed as the "high water mark" for hostility towards target rebate systems. In *Tomra*, while the EC and EU courts still applied the strict approach of considering target rebates to be presumed anticompetitive, the Advocate General ("**AG**") emphasised the correctness of the EC's approach in assessing the potential for anticompetitive effects "*in the circumstances of the case*" as opposed to in the abstract.[34] Subsequent cases – albeit dealing with retroactive quantity rebates in the case of *Post Danmark II* and exclusivity rebates in the case if *Intel* – moved away from the strict approach taken in these cases and, as discussed later in this paper, the EU courts have over the past two decades begun to adopt a more effects-based approach to such rebates.[35]

## 2.3 Retroactive quantity rebates

Under a retroactive quantity rebate system, a rebate is granted on conditions that apply to all customers (i.e. standardised conditions), for example, based on meeting a generally applicable sales threshold. In contrast to the above categories, where the relevant threshold is set on an individual (purchaser-by-purchaser) basis, retroactive quantity rebates are offered on the same basis to all (or the entirety of a group / the whole category of) purchasers. In principle, therefore, any anticompetitive effect of such a system is "blunted" because of the inability to target individual purchasers' volume requirements.[36]

These kinds of retroactive quantity rebates have generally been considered to be lawful,[37] though, as will be discussed, retroactive quantity rebates were impugned as "loyalty inducing" in one of the Focus Cases: *Michelin II* (in a divergence from precedent).[38] The EC based its findings, among other things, on the fact that the *number* of these retroactive quantity rebates (nearly 60 in some years), meant that it could have effectively corresponded with dealers' maximum requirements.[39] The EC did not analyse whether these thresholds were used to deal with any particular business reality nor

[32] *BA/Virgin (EC)*, para. 30.

[33] *BA/Virgin*, paras. 272-273.

[34] Opinion of Advocate General Mazak in Case C-549/10 P, *Tomra Systems ASA and others v Commission*, paras. 43-44.

[35] See e.g. Case C-23/14, *Post Danmark A/S v Konkurrenceradet* EU:C:2015:651 ("***Post Danmark II***"); *Intel*, para. 29.

[36] O'Donoghue and Padilla, page 1228.

[37] *Hoffmann-La Roche*; *Post Danmark II*; *Intel*; Case C-310/93 P, *BPB Industries Plc and British Gypsum Ltd v Commission of the European Communities* EU:C:1995:101 ("***British Gypsum***").

[38] *Michelin II,* paras. 64-66.

[39] O'Donoghue and Padilla, page 1232.

whether they were targeting particular groups of dealers. Moreover, tiered rebates have also generally been considered as less restrictive and closer to incremental rebates, since each step in the tariff is likely to be smaller.

The EC also found that the structure of the system meant that dealers risked making an overall loss unless they obtained the highest rebate.[40] Rebates with a relatively long (one year) reference period were presumed to be abusive, absent economic justification. The CFI noted that towards the end of the reference period, buyers would face increased pressure to reach the target threshold in order to secure a rebate for the entire period. However, the CFI did not consider whether economic theory would support the increase in such pressure, nor did it seek to identify its source or make any qualitative or quantitative analysis of the influence of this factor on merchant's behaviour (in particular in terms of risk or loss aversion).

In line with the trend across all conditional rebate cases (and the Priorities Guidance[41]), more recent cases have moved towards an effects-based approach to the assessment of retroactive quantity rebates. In *Post Danmark II*, which concerned retroactive (standardised) all-unit rebates, while the ECJ recognised the potential for all-unit rebates, especially those based on annual reference periods, to have a strong marginal impact, it nonetheless emphasised the need to consider the actual effect of the rebate and, in particular, noted that the as efficient competitor ("**AEC**") test as an important tool in assessing such effect.[42]

## 2.4 Incremental rebates

Under an incremental rebate system, the meeting of the condition for a rebate to be applied does not result in a discount on *all* units, but only on those within the relevant tranche or increment. Incremental rebates could be individualised or standardised. The effect of the rebate on the customer's incentives inevitably depends upon the conditions by which it is met and the level at which it is set (as well as what proportion of the customer's own demand is captive to the dominant supplier).

These kinds of rebates – which do not feature in the Focus Cases – have generally been considered to present a lower foreclosure risk than target rebates. For example, in *Michelin II*, the CFI stated that "*the incentive to purchase created by a quantity rebate system is therefore much greater when the rebates are calculated on total turnover achieved during a certain period than when they are calculated only tranche by tranche*".[43] The EC has expressed the same view, first in its 2005 Discussion Paper,[44] with the position confirmed in its Priorities Guidance, which indicates that for incremental rebates, a predatory pricing analysis has generally been used to determine their effect.[45] In 2009, the year after the Priorities Guidance was published, the EC closed its investigation into *Velux* over its incremental rebate scheme, concluding they were "*very unlikely to bar competitors from access to the market*", noting the incremental nature of the rebates and the relatively short reference periods in question.[46]

---

40 *Michelin II (EC)*, para. 218.

41 Guidance on the Commission's enforcement priorities in applying Article 102 to abusive exclusionary conduct by dominant undertakings (OJ 2009 C45/7) ("**Priorities Guidance**").

42 *Post Danmark II,* para. 61.

43 *Michelin II*, para. 88.

44 DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses (2005), para. 166 ("**Discussion Paper**").

45 Priorities Guidance, para. 42.

46 Case AT. 40026, *Velux*, 14 June 2018, para. 8.

### 3 The merits and limitations of classification

While the above framework is useful for classifying and understanding different kinds of rebates, the categories are not strict in reality. At least three of the four categories identified are not mutually exclusive: (i) standardised rebates linked to exclusive or near-exclusive dealing may be *de facto* exclusive (although that is unlikely, as they are standardised); (ii) target rebates may also be *de facto* exclusive; and (iii) retroactive quantity rebates may become *de facto* close to target rebates if you have multiple thresholds.

In addition, a significant number of landmark cases have each created their own categories, including two of the three Focus Cases, namely *Michelin I* (which created a new category of target rebates) and *BA/Virgin* (for retroactive quantity rebates). This classification is therefore often not the result of an *ex-ante* analysis of the effects of non-linear prices based on experience, but rather an *ex-post* rationalisation based on the concerns that emerged in the context of a few very specific cases brought to the attention of the EC by complainants. As such, the classification is liable to evolve and, while useful for understanding historical cases, does not in itself provide a sound basis for assessment.

## B. Economic assessment of conditional rebates

### 1 Pro-competitive rationales

The terms “retroactive” or “loyalty enhancing” are not economic terms. Therefore, the classification presented in **Section III.A.2** does not correspond to an economic categorisation. Rather, economists naturally classify prices according to their dependencies. In particular, prices can be:

(i) related to the identity of the buyer;

(ii) related to the quantities bought from competing suppliers (this includes exclusivity conditions and market share thresholds); and / or

(iii) related to the quantities purchased (such aspect is generally referred to as “not conditional” by economists).

Prices can fall within several categories at the same time. For instance, an individualised quantity discount added to a rebate conditional on a market share threshold falls in all three categories. There has to be a reason why all these features are used together. Therefore, it would be artificial to assess these aspects independently of each other. In fact, these features are complementary, and they have an effect that goes beyond the sum of their parts.

The type of tariff that will appear optimal from the perspective of the supplier (and possibly to both the supplier and the buyer) will naturally depend on the issue that the tariff intends to address. However, it will also depend on the type of information that is available and can be legally included in a contract. For instance, if prices have to be based on general terms of sale, the ability to propose completely different price structures will be limited. In such a situation, it will be necessary to alter the *shape* of a general tariff to provide different prices to actors in different situations. This will be necessary when the factors that are relevant for the supplier cannot be observed (e.g. the sales effort of a dealer) or when they cannot be put in a contract (e.g. the retailer’s downstream prices).

Non-linear prices expose buyers to different parts of the tariff. They can be useful from the perspective of the seller offering prices to buyers who have different characteristics. It is also useful when buyers have the ability to behave in qualitatively different ways. Exposing buyers to different kinds of prices gives them the incentives to self-select.

These different motives will lead to different kinds of prices. In particular, optimal prices could either be continuous or not. EU case law has regularly referred to rebates as being “retroactive” when total prices showed a disparity with the quantity purchased. In our opinion, this is a misleading term, as it implies that buyers make sourcing decisions without anticipating the influence of their choices.

EU case law has also emphasised that such disparities lead to negative prices and suction effects, which necessarily correspond to an intent to foreclose. While such a disparity could be intentional, using a few examples in this Section, we will show that it could also be a by-product of the necessity to design tariffs with different levels and slopes. Moreover, as we discuss in **Section III.B.2** below, such disparities should be assessed by taking into account the characteristics of demand and of the types of strategic decisions that the parties are likely to take. It is particularly important assess whether some customers are likely to cross the thresholds where such discontinuity occurs and, if they do, by what magnitude.

It is generally possible to divide the purposes of non-linear tariffs in two broad categories: (i) prices that respond to asymmetric demands and competitive conditions; and (ii) prices that intend to modify the strategic decisions of the buyer on factors that affect the supplier. In this Section, we refer to “price discrimination” motives for the first category, and to “alignment of incentives” motives for the second.

### 1.1 Price discrimination

Customers may have different characteristics of demand, in their outside options or their bargaining powers. Being able to propose different prices to different customers is always more profitable for sellers. The effects on buyers are more ambiguous. However, in general, economic theory regards price discrimination that allows a producer to increase its total sales as likely to be welfare enhancing when compared to uniform pricing, as it leads to higher overall output. On that basis, prohibiting the firm from price discriminating would harm consumers, as it would lead to a decrease in the total output.

Price discrimination can also be a response to competitive pressure. A seller may not find it profitable to reduce their price uniformly when dealing with economies of scale. However, they can decide to respond to a rival’s aggressive pricing strategy by setting a price closer to their marginal cost through an incremental quantity rebate scheme. This logic could apply either to different customers or to different part of the demand of a given customer. In this context, if price discrimination can increase the total output sold on the market, it will benefit both sellers and final consumers. This is particularly relevant where price discrimination allows a supplier to recover their fixed costs more efficiently using demand elasticities (this is known as “Ramsey pricing”).

On balance, the benefits of price discrimination to consumers depend on the level of sales with uniform prices and the strength of competition.

It is also important to note that price discrimination could be implemented through any of the types of non-linear prices presented above.[47] It could, in particular, require rebates that appear retroactive (i.e. that are discontinuous). Imagine that two types of buyers can use a seller’s product: (small) independent repair shops and (large) industrial manufacturers. Imagine as well that industrial

[47] For a general discussion on the use of non-linear prices for price discrimination, see Armstrong, ”Nonlinear Pricing”, Annual Review of Economics 8(1), pp. 583-614 (2016).

manufacturers have stronger outside options (they could use a wider variety of inputs for instance). Then, competition would lead to higher unit prices for small manufacturers than for larger industrial manufacturers. If the seller cannot propose two different price structures to the two different types of buyers, the optimal tariff is discontinuous. In particular, imposing an incremental discount is logically equivalent to imposing a two-part tariff with a positive fixed fee to the industrial manufacturers, which would reduce the aggregate price they pay.

### 1.2 Alignment of incentives

In addition, non-linear prices are a natural answer to various types of coordination issues that can emerge in the context of vertical chains. Non-linear prices can therefore correspond to any of the procompetitive rationales of vertical restraints.

**Reducing double marginalisation**. One of the most common issues that can emerge in the context of vertical chains is double marginalisation. This happens when an intermediary firm earns a positive margin on top of the margin already earned by its supplier. This double marginalization translates to higher final prices for consumers as compared to the same situation absent an intermediary. Double marginalisation requires significant market power both upstream and downstream. This is not necessarily a very common phenomenon, but it is more likely to emerge in the context of dominant undertakings. Double marginalisation mostly emerges with linear prices. The most natural theoretical answer to it is a tariff that contains a fixed fee and a unit price closer to marginal cost of production. In a context where larger buyers are more likely to have downstream market power (e.g. in local markets) and the supplier cannot offer different price structures to different types of buyers, the optimal price structure will also appear to be “retroactive”.

**Facilitating pro-competitive vertical cooperation**. In addition, non-linear prices can align the distributor’s and the sellers’ incentives and induce forms of vertical cooperation that benefit all parties, including consumers. The simplest example of such vertical cooperation concerns joint investments in the quality of service to final consumers. This might require suppliers’ investing in their distributors such that better service can be offered to ultimate customers, without concerns about whether the investment will be recouped (i.e. avoiding a potential moral hazard where the supplier’s investment is relationship-specific). This can also concern incentives that need to be given to sellers to provide an adequate level of service themselves. Sellers add value to suppliers’ products when they provide complementary services (e.g. product promotion, after sales services, ensuring that there is the appropriate stock such that it fits the demand). These complementary services are valuable for both upstream firms and final consumers but are costly for the intermediary customer. As customers choose the level of services related to their private marginal benefit and marginal cost, they do not take into account the benefits to the supplier. By exposing sellers to different levels of unit and aggregate prices depending on their actions (e.g. if they manage to sell larger quantities), non-linear prices are useful to align all parties’ interests. In some instances, in particular when final demand is uncertain, or when it is difficult to relate sold quantities to cooperation efforts, aligning all parties’ interests will require tariffs that are truly conditional in the sense presented in this introduction, e.g. exclusivity conditions or rebates based on market share thresholds.

That such mechanisms could be pro-competitive is not equally plausible in any market context. In addition, they could limit ex post competition, for instance by limiting buyers’ ability to renegotiate contracts or switch suppliers. The form of protection they provide can however be necessary to preserve ex ante incentives to invest.

## 2 Theories of harm

While conditional rebates of any form can correspond to procompetitive rationales, they can also lead to anticompetitive outcomes through various mechanisms whose effects are described as “theories of harm”. As non-linear prices are intrinsically related to price discrimination, the first theory of harm is that the dominant company is exploiting market power. While such harm is always possible, it is difficult to establish. For this reason, the focus of our paper is on exclusionary conduct. Most of the corresponding theories of harm involve various categories of non-linear pricing identified in the case law and described above. These different theories of harm are likely to emerge under different circumstances and market conditions (e.g. dominance, barriers to entry, economies of scale, levels in the supply chain, degree of downstream competition). Consequently, the economic assessment has to be based on the most likely theory of harm in the legal and economic contexts in which the relevant practice takes place; rather than on the mere form of the practice.

Conditional rebates have most commonly been seen through the lens of naked exclusion:[48] the incumbent finds a way to pay its customers (e.g. through discounts or rebates) to supress their incentive to switch to a rival.[49] However, other relevant theories of harm include predatory pricing, raising rivals’ costs and demand boost. We outline the main theories here in turn and analyse how they should be assessed in the context of our economic framework. We then make a similar assessment of the potential procompetitive rationales for non-linear pricing.

### 2.1 Predation

First, non-linear pricing could be used to implement predation. Predation is where a firm sacrifices short-term profits to foreclose rivals, generally by setting a price that no competitor could profitably match in the long term. The company engaging in the predatory strategy must have an advantage which enables it to exclude competitors, and buyers also need to abide by such a coercing scheme. For example, the company may have more resources (liquidity, inputs, capacity or technology), may be an unavoidable trading partner (on the same market or a related one), or there could be asymmetry of information between the different parties. Indeed, predation is generally only capable of having anticompetitive effects where pursued by a dominant firm.

For predation to succeed, the company needs to keep prices lower than would be justified by short term equilibrium conditions for a sufficiently long period to effectively harm and thereby exclude its rival(s). Then, during the recoupment period, it enjoys the release of competitive constraints and recoups the profit lost during the predatory phase. The strategy is profitable only if the expected long-term profit outweighs the short-run profit lost. This requires a sufficient future margin as well as a high chance of succeeding in the rival’s foreclosure. A predation strategy is unlikely to succeed in markets with low barriers to entry, because new firms could easily enter and resurrect competition.

Predation in the form of generalised low prices is very expensive for the dominant company. A predatory pricing strategy through rebates directed towards critical parts of the demand is less costly (e.g. because the discount is only offered to customers who are most likely to buy from rivals and/or quantities that are most likely to be addressed by such rivals). However, the assessment of predation with selective prices is largely similar to the assessment of predation with generally low prices (with the exception of coverage, discussed below).

Finally, for the predation theory of harm to hold, the low prices need to prevent access to a sufficient number of customers to be capable of anticompetitively foreclosing competitors. Where general

[48] Segal and Whinston, “Naked Exclusion: Comment”, *American Economic Review,* 90(1), pp. 296-309 (2000).

[49] Rasmusen, Ramseyer and Wiley, “Naked Exclusion”, *American Economic Review,* 81(5), pp. 1137-1145 (1991).

price levels are reduced, in the most classical predation cases, coverage (i.e. the proportion of the customer base covered by the strategy) is sufficient to be capable of generating harm (since it covers all the products and customers that the firm addresses). This is not the case if low prices only cover certain products or customers. And this is generally the case for predation through selective prices. In this context, it needs to be assessed whether these products or customers are sufficiently strategic to allow for competitors to compete effectively on the market (which we discuss in the context of naked exclusion below).

## 2.2 Naked exclusion

Instead of recouping the sacrificed profit on future sales, it is also possible for dominant firms to recoup these lost profits on certain sales or for certain customers. Such a mechanism is typically defined in the economic literature as "naked exclusion".[50]

**Buyer coordination.** In basic terms, naked exclusion arises when a putative market entrant needs to secure a minimum number of customers to be able to operate, and the incumbent needs to exclude a potential entrant through exclusive dealing. In this setting, the incumbent is able to lock in enough buyers or volumes purchased into the exclusive system to prevent the entrant from achieving the minimum sales it needs to operate profitably. From a first principles approach, this situation would appear most likely to arise where buyers are unable to coordinate themselves "against" such a strategy and towards a preferred equilibrium.

The incumbent, in such cases, may not need to engage in a below-cost pricing strategy to foreclose competitors. Rasmussen, Ramseyer and Wiley (1991)[51] and later Segal and Whinston (2000)[52] explored the conditions necessary for such naked exclusion to emerge. Segal and Whinston found that when an incumbent firm is able to secure exclusive contracts with buyers, it does not need to rely on buyers' lack of ability to coordinate in order to successfully exclude potential rivals. They also showed that, through the exploitation of buyers' externalities, the incumbent could also profitably exclude the entrant.

**Downstream competition**. Various papers have taken different views on the importance of downstream competition to the ability of a dominant entity to execute a naked exclusion strategy. Fumagalli and Motta in 2006[53] and Wright in 2009[54] explored the role of downstream competition in a mechanism close to that considered by Segal and Whinston.[55] Their findings were ambiguous. In fact, Fumagalli and Motta found that, when there is strong downstream competition, retailers have a strong incentive not to participate in the exclusive dealing system and to buy from a more efficient supplier. By contrast, Abito and Wright in 2006[56] found that overall, more intense downstream competition seems to favour naked exclusion. With strong competition, downstream firms make very low margins. Therefore, the incumbent and downstream retailers can both increase their profit

[50] The term "naked exclusion" in this section refers to a particular strand of economic theory. The term also has a narrower meaning in EU law. For example, see Rasmusen, Ramseyer and Wiley, "Naked Exclusion", *American Economic Review*, 81(5), pp. 1137-1145 (1991).

[51] Rasmusen, Ramseyer and Wiley, "Naked Exclusion", *American Economic Review*, 81(5), pp. 1137-1145 (1991).

[52] Segal and Whinston, "Naked Exclusion: Comment", *American Economic Review*, 90(1), pp. 296-309 (2000).

[53] Fumagalli & Motta, "Exclusive Dealing and Entry, when Buyers Compete", *American Economic Review*, 96(3), pp. 785-795 (2006).

[54] Wright, "Exclusive Dealing and Entry, when Buyers Compete: Comment", *American Economic Review*, 99(3), pp. 1070-81 (2009).

[55] Segal & Whinston, "Naked Exclusion: Comment", *American Economic Review*, 90(1), pp. 296-309 (2000).

[56] Abito & Wright, "Exclusive Dealing with Imperfect Downstream Competition", *International Journal of Industrial Organisation*, 26(1), 227-246 (2008).

through exclusive deals that prevent entry and share the resulting monopoly profits. A few years later in 2009, Wright concluded that downstream competition changes the economics of exclusive dealing but does not make anticompetitive exclusive deals less likely.[57]

Rebate systems can include conditions on buyers to purchase solely or mostly from the dominant supplier. However, such rebates differ from contractual exclusivity in that customers can – at least nominally – freely choose their suppliers. They can decide to fulfil the condition to get the rebate or not. Therefore, the foreclosure theories in cases of rebates linked to exclusive or near exclusive dealing rely on the price incentives rather than on contractual clauses.

It is important to note that the literature on naked exclusion points towards two versions of this theory of harm. In the first, competitors are naturally prevented from entering due to lack of ability to coordinate among buyers. This outcome could emerge due to market circumstances (including competition law, that prevents buyers from entering into contracts to coordinate their sourcing decisions). This version of the theory of harm does not require large rebates, but successful foreclosure is not certain. In addition, for such a theory to be plausible, buyers' ability to renegotiate needs to be limited. If buyers are able to renegotiate, they could reject exclusivity once other customers do so as well, which would foster entry. For this reason, this theory of harm is unlikely to be plausible, unless potential competitors are very small and contracts (or reference periods of rebates) are particularly long.

The second version of this theory of harm arises in a scenario where a dominant supplier makes coordination difficult for buyers by making selective offers to a particular group (or groups) of customers. Such a strategy is easier to implement, but it requires the existence of one customer, or a group of customers, whose cooperation is sufficient to have a wider impact on the whole market. It is more certain, but it is also more costly: such strategic customers need to be paid a foreclosure premium (i.e. an inducement to accept reduced competition).

### 2.3 Other theories of harm related to quantity and target rebates

Another strand of the literature explores how rebates can be used for downstream firms to coordinate on a less competitive equilibrium and keep out upstream entrants.[58] Rebates can also be used to foreclose a new entrant when there is uncertainty.[59]

According to Carlton and Waldman (2008),[60] quantity discounts and bundled pricing mechanisms can benefit consumers by generating efficiency gains or enabling the company to increase its total output through price discrimination. However, they find that quantity discounts can also harm competition to the extent that they deprive rivals of the minimum scale of operation necessary to be efficient and succeed on the market. They propose a test to assess the effect of the discount systems

[57] Wright, "Exclusive Dealing and Entry, When Buyers Compete: Comment", *American Economic Review*, 99(3), pp. 1070-81 (2009).

[58] Asker & Bar-Isaac, "Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals", *American Economic Review,* 104(2), pp. 672-86 (2014); DeGraba, "Naked Exclusion by a Dominant Input Supplier: Exclusive contracting and loyalty discounts", *International Journal of Industrial Organization,* 31(5), pp. 516-526 (2013); Simpson & Wichelgren, "Naked Exclusion, Efficient Breach, and Downstream Competition", *American Economic Review,* 97(4), pp. 1305-1320 (2007).

[59] Aghion & Bolton, "Contracts as Barrier to Entry", *American Economic Review,* 77, 388-401 (1987); Choné & Linnemer, "Nonlinear Pricing and Exclusion: I. Buyer Opportunism", *RAND Journal of Economics*, 46(2), pp. 217-240 (2015), (2016); Choné & Linnemer, "Nonlinear Pricing and Exclusion: II. Must-stock Products", *RAND Journal of Economics*, pp. 631-660 (2016).

[60] Carlton & Waldman, "Safe Harbors for Quantity Discounts and Bundling", EAG Discussion Papers 200801 (2008).

on competition. This test mainly focuses on whether competitors are able to survive and serve their customers as efficiently as they could have in the absence of a potentially abusive pricing scheme.

Regarding quantity discounts, in 2011, Calzolari and Denicolò[61] found that the exclusionary effect of rebate systems on social welfare is ambiguous and depends upon the degree of market asymmetry (in particular, the differences in efficiencies among the market players) and the extent of product substitutability. Indeed, they found that quantity discounts that facilitate the exit of less efficient firms offering close substitutes have a positive effect on social welfare. However, they also observed that quantity discounts reduce consumer surplus and harm rivals in highly asymmetric markets or when products are weak substitutes. To deal with these two opposing effects, they used the Carlton and Waldman test and established market conditions “thresholds” for which kinds of quantity discounts ought to be prohibited. They conclude that when the market is highly asymmetric and products are fairly close substitutes, authorities should prevent dominant undertakings from offering quantity discounts because it reduces social welfare. This approach certainly requires a detailed assessment.

Salinger in 2017[62] and Chao, Tan and Wong in 2018[63] show that dominant firms can partially foreclose rivals by using target rebate schemes. These models are dependent on the structure of demand being such that customers *must* source some but not all products or volumes from the dominant incumbent (i.e. there is a portion of demand which is captive to the dominant incumbent, and another portion which is “contestable”). Chao, Tan and Wong developed a model in which an incumbent firm designed a target rebate system that allowed it to tie part of the contestable share of demand to its captive demand. More precisely, for target rebates, a dominant company can use the inelastic part of the demand to induce buyers to purchase a larger proportion of their needs (in the competitive portion of demand) from the incumbent. By using this mechanism, an incumbent firm is able to leverage its market power from the captive to the competitive portion of the demand. They find that these schemes have potential foreclosure effects on the competitive portion of the market.

In Chao, Tan and Wong’s model, there are no fixed costs, buyers have no ability to negotiate, and the dominant firm enjoys a captive demand because the capacity of its rival is constrained. They find that in these circumstances, target rebates offered by the dominant firm always harm the rival, the effect on consumer welfare is negatively correlated with the level of the rival’s capacity constraint, and that the dominant firm increases its profit only if the pricing scheme does not foreclose the whole demand. Salinger analysed a similar setting and found that cliff discounts could have procompetitive effects but that the harm arose from the resulting decrease in market competition, rather than from exclusion by itself.[64] Salinger also indicated that an optimal target rebate contract did not result in exclusivity.

Therefore, under both Salinger and Chao, Tan and Wong’s models, target rebates are seen to have potentially anticompetitive effects, but neither establish that such effects will arise in all circumstances.

---

[61] Calzolari & Vincenzo, “On the Anti-competitive Effects of Quantity Discounts”, *International Journal of Industrial Organization,* 29(3), pp. 337-341 (2011).

[62] Salinger, “All-units Discounts by a Dominant Producer Threatened by Partial Entry”, *Antitrust Law Journal*, 81(2), pp. 507-536 (2017).

[63] Chao, Tan & Wong, “All-units Discounts as a Partial Foreclosure Device”, *RAND Journal of Economics,* 49(1), pp. 155-180 (2018).

[64] Salinger, “All-units Discounts by a Dominant Producer Threatened by Partial Entry”, *Antitrust Law Journal*, 81(2), pp. 507-536 (2017).

## 2.4 Raising rivals' costs

Some authors have argued that rebates should not only be seen as a profit sacrifice intended to directly foreclose rivals, but more generally as a strategy to raise rivals' costs. This view was put forward by Moore and Wright in 2015[65] and Salop in 2017.[66] According to this theory, exclusive dealing does not necessarily remove rivals from the market. Rather, it can serve to reduce rivals' economies of scale and, consequently, increase their costs, hindering their competitiveness and reducing competition on the market. While this can cause harm to competitors, the main criticism of this approach is that there is no limiting principle that allows to determine when consumer harm is likely. Consequently, it is very difficult to imagine how this theory of harm could be translated into a structured rule, like the as efficient principles presented in **Section III.D**.

## 2.5 Demand boost

Finally, yet another strand of literature promoted by Calzolari and Denicolo in 2015,[67] 2018[68] and 2020,[69] analyses how a dominant company can boost demand for its products through rebates without necessarily sacrificing any profit. Loyalty enhancing rebates, in this case, would have a similar effect to exclusive dealing. They deprive customers of variety and compensate them by lowering the final price. Then, instead of competing on the marginal unit price, the companies compete for a whole market, which eliminates the importance of price differentiation.

This theory of harm assumes that authorities will declare exclusive dealing unlawful when some conditions are satisfied even without applying price cost tests. Indeed, in 2018, Calzolari and Denicolo found that price-cost tests are not relevant to assessing this theory of harm and may be misleading.[70] Moreover, Calzolari and Denicolo (2020) also found that when the dominant company has a strong competitive advantage, exclusive dealing is profitable for the dominant firm and always harms rivals and final consumers.[71] However, when the dominant firm has only a weak advantage, exclusive dealing is not profitable and increases consumer welfare. Indeed, when it holds strong competitive advantages, the dominant company does not need to lower its prices significantly. Then exclusive dealing produces anticompetitive effects because it forces consumers to increase their demand for the dominant firm's product in preference to smaller rivals.

## 2.6 Other theories

Edlin and Farell[72] add an additional theory of harm to the discussion of anticompetitive rebates. They write that a "*monopoly may not block improving trade between customers and rivals who would offer customers a better deal*". In a monopoly setting, this can happen because rivals may have to compete against a virtual price lower than the actual price paid by the customers of the dominant firm. To explain this, Edlin and Farell propose the simple following model. The monopolist "M"

---

[65] Moore & Wright, "Conditional Discounts and the law of Exclusive Dealing", *George Mason Law Review*, 22(5), pp. 1205 – 1246 (2015).

[66] Salop, "The Raising Rivals' Cost Foreclosure Paradigm, Conditional Pricing Practices, and the Flawed Incremental Price-Cost Test", 81(2), pp. 371-422 (2017).

[67] Calzolari & Denicolò, "Exclusive Contracts and Market Dominance", *American Economic Review*, 105(11), pp. 3321-3351 (2015).

[68] Calzolari & Denicolò, "Price-cost Tests and Loyalty Discounts", CEPR Discussion Papers 12924 (2018).

[69] Calzolari & Denicolò, "Exploring Rivals' Strengths", Calzolari, Giacomo and Denicolò, Vincenzo, Exploiting Rivals' Strengths CEPR Discussion Paper No. DP15520 (2020).

[70] Calzolari & Denicolò, "Price-cost Tests and Loyalty Discounts", CEPR Discussion Papers 12924 (2018).

[71] Calzolari & Denicolò, "Exploring Rivals' Strengths", Calzolari, Giacomo and Denicolò, Vincenzo, Exploiting Rivals' Strengths CEPR Discussion Paper No. DP15520 (2020).

[72] Edlin & Farrell, "Freedom to Trade and the Competitive Process", NBER Working Paper No. 16818 (2011).

charges a high price “H” but would cut it to a low price “L” in case of entry. Rival(s) “R” knows “L” and cannot compete at this level. But “R” could offer a median price “PM” lower than “H” that would improve the situation of customers. In spite of this, however, “R” will not enter, conjecturing retaliation at “L”. Customers will be deprived of an improvement. In the model, “R” competes with a virtual price lower than that actually charged to customers.

One flaw in the Edlin and Farell model, that the authors concede, is that “L” represents an *ex post* improving coalition if entry occurs. An even more fatal defect is the following: in real markets, there are two possible states of the world. In the first state of the world – that imagined by E & F – “R” knows “L”. There is perfect (or quasi-perfect) information. The reasons for this situation of informational perfection may be diverse: “M” may have disclosed “L” in the past during a previous anti-entry campaign; “M” may be subject to a regulatory duty (to disclose cost information, to approximate prices to cost, etc.); the product manufactured by M is a commodity, technology is mature, etc.; “M” has explicitly threatened “R” from “L” through press announcements, etc. The bottom line is that in all these cases, there is market transparency on “L”. With this in mind, it should be equally, and safely, assumed that customers are also aware of L (especially if they are experienced industrial customers). This, in turn, has a critical implication: customers can and will first seek to form an improving coalition with M, and strike the best possible deal with it. And if they do not get it, customers will turn to “R” who will give them L<PM<H. In both scenarios, there will be an improving coalition as to the real conditions of the market, and the competitive process will be kept intact.

In the second state of the world, “R” does not know “L”. There is imperfect information. In this variant, it is reasonable to assume that R must randomly under or overestimate “L”. The unconfident R will overestimate L (L’<L). They will not enter the market. And the confident R will underestimate L (L’’>L). They will thus not compete against the real “L”, but against a price they believe they can beat, and that is lower than “H”. The confident “R” will again enter the market and offer better coalitions to customers. The Edlin and Farell model of virtual limit pricing is thus not entirely in line with real world observations.

## C. Legal considerations: the object / effect distinction as a framework for understanding treatment of rebates under Article 102 TFEU

Article 102 TFEU prohibits the abuse of a dominant position in general, and while it specifies certain conduct which could constitute such an abuse, it does not establish an exhaustive list of “prohibited” conduct.

### 1 Categories of abuse in context

Over time, numerous categories of abuse have developed under Article 102 TFEU, both in relation to non-pricing abuses (e.g. refusal to supply, tying, exclusivity) and pricing abuses (e.g. predation, margin squeeze), including various categories of abusive rebates (as set out above). For each of those categories, the EC and the EU courts have developed separate legal tests based on varying evidential standards. For some of those categories, it is sufficient to establish that the measure in question is capable of causing anticompetitive effects. In other words, that anticompetitive effects are a plausible outcome of carrying out such a measure. An example is predatory pricing, where the ECJ concluded in *AKZO v Commission* that below cost prices are capable of excluding equally efficient rivals.[73] Other categories of abuse impose a stricter standard on the authorities, requesting them to show actual or likely effects, as was the case in *MEO*,[74] where the ECJ held that discriminatory pricing can constitute an abuse only where the behaviour in question "*has an effect on the costs, profits and any other relevant interest"* of one or more of the companies involved.[75] Finally, for the third category, even a likely anticompetitive effect is not sufficient to establish an abuse: the authorities need to demonstrate “indispensability” (i.e. that the measure would eliminate all viable competition on the relevant market). This standard has been applied in certain refusal to supply cases.

The multitude of tests has led to much confusion, in particular in relation to the standard to which anticompetitive effects need to established or observed (e.g. whether the putatively abusive conduct need only be *capable* of restricting competition, or if it must be *likely*).[76] This is partly due to the lack of a clear overarching framework which puts into context the various tests and standards which have been developed on an *ad hoc* basis. The situation has also not been helped by the fact that the underlying presumptions that form the basis of those tests have often not been made explicit, let alone rigorously tested.

As a working hypothesis, one can identify an inverse relationship between the presumption of harm for a particular type of abuse and the evidential standard which is applied to such an abuse: the less likely the presumed competitive harm of a particular type of unilateral behaviour, the stricter the evidentiary requirement for an authority to establish an abuse. The same is also true in reverse: the more likely the harm, the lower the evidentiary requirement. This is shown in **Figure 1** below.

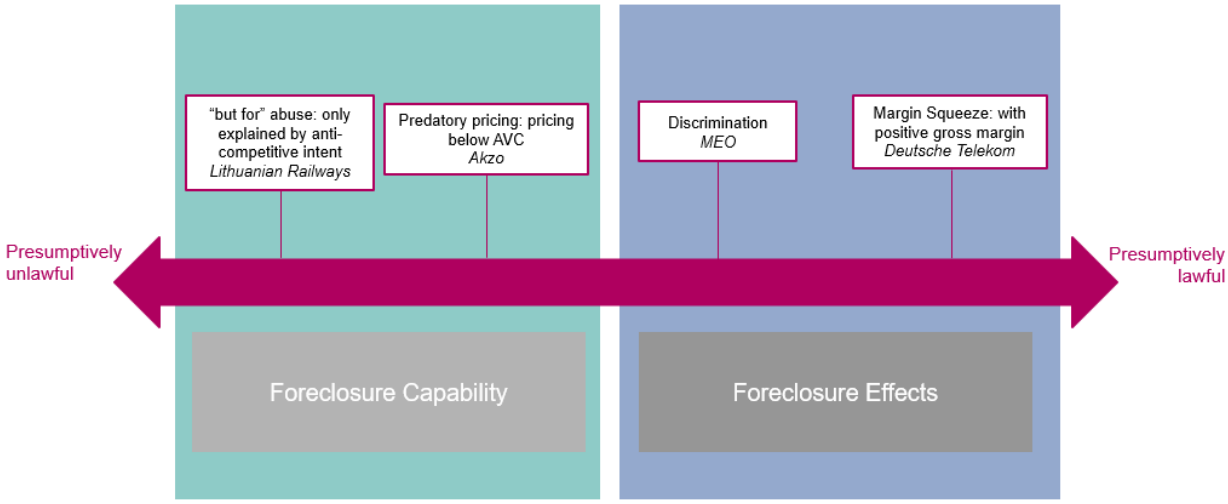
[73] Case C-62/86 *AKZO v Commission* EU:C:1991:286 (“***AKZO v Commission***”), para. 72.

[74] Case C-525/16, *MEO v Autoridade da Concorrencia* EU:C:2018:270 (“***MEO***”).

[75] *MEO*, para. 37.

[76] Colomo, “Capability and likelihood of anticompetitive effects: why the difference exists and why it matters”, Chillin'Competition, 29 January 2021, available at < Capability and likelihood of anticompetitive effects: why the difference exists, and why it matters | Chillin'Competition (chillingcompetition.com)>.

**Figure 1 Categories of abuse**




## 2 The object and effect dichotomy under Article 101 TFEU

The confusion which characterises the position under Article 102 TFEU is in stark contrast to the position under Article 101 TFEU, where the EU courts have done much to develop an overarching framework, and which clarifies the relationship between the two main types of restrictions, namely object and effect restrictions.

AG Bobek in his Opinion in *Budapest Bank*[77] provides a clear synthesis of the legal position.

As a **starting point**, AG Bobek deals with the question of whether the same conduct can restrict competition under Article 101(1) TFEU both "by object" and "by effect". According to AG Bobek, the answer to that question is clearly affirmative:

> The "*object/effect dichotomy is, by and large, a procedural device meant to guide the competition authority on the analysis to be carried out under Article 101(1) TFEU depending on the circumstances of the case. An authority is not required to carry out a fully-fledged analysis of the effects of an agreement – which is often lengthier and more resource intensive – when it maintains and establishes that the agreement is anti-competitive by object*."[78]

Object restrictions are defined as a type of "*coordination between undertakings which reveal a sufficient degree of harm to competition and for which it is thus unnecessary to examine their effects*". This is justified by the fact that certain types of arrangement can be regarded "*by their very nature as being harmful to the proper functioning of normal competition since they normally produce inefficient outcomes and reduce consumer welfare*".[79]

To assess whether a restriction falls into the object category, the EU courts apply a two stage analysis. At the **first stage**, the focus is mainly on the "*content of the provision of the agreement*

[77] Opinion of AG Bobek, Case C-228/18, *Gazdasági Versenyhivatal v Budapest Bank Nyrt* ("***AG Bobek Budapest Bank Opinion***").

[78] *AG Bobek Budapest Bank Opinion*, para. 27.

[79] *AG Bobek Budapest Bank Opinion*, para. 40.

*and its objectives*"; the key question is whether the "*agreement in question falls within a category of agreements whose harmful nature is in the light of experience commonly accepted and easily identifiable*".[80] Two points to note here: (i) the analysis looks at the nature of the 'category of agreements' (e.g. horizontal price fixing agreement), not the individual agreement in question; and (ii) the emphasis at this stage of the analysis is on "experience".

What is required is "*robust and reliable experience about the nature of the agreement*".[81] If there is no consensus about a practice (e.g. about its nature of effects on competition), then an object analysis is not appropriate. Furthermore, consensus can change over time in light of new economic theories or evidence.

At the **second stage** of the analysis, "*the authority is required to verify that the presumed anticompetitive nature of the agreement, determined on the basis of a merely formal assessment [at stage 1], is not called into question by considerations relating to the legal and economic context in which the agreement was implemented*".[82]

AG Bobek makes clear that "*a purely formal assessment of an agreement*" (or one "*detached from reality*" as he puts it) is inappropriate, even in the context of an object restrictions, as it "*could lead to condemning innocuous or pro-competitive agreements*".[83]

In order to demonstrate that an agreement is by its very nature harmful to the proper functioning of normal competition, the authorities have to show that the agreement has no plausible purpose other than the restriction of competition. This can be seen as a 'but for' screen: the restrictions make no sense but for their anticompetitive purpose.[84] AG Bobek applies a slightly stricter test: an agreement cannot be classified as restrictive of competition by object where it *"could reasonably have had some pro-competitive effects and those positive effects are not clearly outweighed by other, more profound, anti-competitive effects*".[85] In other words, what seems to matter may be plausible <u>net</u> efficiencies.

Where an agreement has been established as a restriction by object, the authorities need to consider the actual or potential lawful competition which would have existed in the absence of the agreement, and it is open to the parties to argue that an agreement is "*not capable of restricting competition*".

By contrast, where an examination of the object of the agreement "*does not reveal the effect on competition to be sufficiently deleterious, the consequences of the agreement should then be considered*"[86] (i.e. an effects analysis must be carried out).

[80] *AG Bobek Budapest Bank Opinion*, para. 42.

[81] *AG Bobek Budapest Bank Opinion*, para. 63; cited by the ECJ in C-228/18, *Gazdasági Versenyhivatal v Budapest Bank Nyrt* EU:C:2020:265, para. 76.

[82] *AG Bobek Budapest Bank Opinion*, para. 43.

[83] *AG Bobek Budapest Bank Opinion*, para. 45.

[84] Case C-307/18 *Generics (UK) Ltd v CMA* EU:C:2020:52.

[85] *AG Bobek Budapest Bank Opinion*, para. 78.

[86] *AG Bobek Budapest Bank Opinion*, para. 25.

# 3 Applying the object and effect dichotomy to Article 102 TFEU

## 3.1 Validity of read across

The question to what extent it is appropriate to have a read-across from the object / effect dichotomy of Article 101(1) TFEU to Article 102 TFEU arises. Indeed, there are arguments against the use of the concepts of “object abuse” and “effects abuse” in line with the developments under Article 101(1) TFEU.

First, on a purely formal basis, contrary to Article 101 TFEU, the wording of Article 102 TFEU does not explicitly refer to infringements by object or by effect. Secondly, while the tests under Article 101 TFEU have been binary and can be neatly classified into the two categories of restriction, the tests developed under Article 102 TFEU have shown far greater variance, and trying to categorise each of them as a by object or a by effect abuse may hide numerous shades of grey.

In the authors’ view, the object-effect concept can be usefully applied to enforcement under Article 102 TFEU as a lens (and terminology) through which to view enforcement practice, not least in relation to rebates. None of the above objections are particularly persuasive.

While Article 102 TFEU does not explicitly identify an ‘object abuse’, pragmatism nevertheless suggests a harmonised approach between Articles 101 and 102 TFEU. Since both provisions regularly apply to the same practice (e.g. an exclusivity obligation), it would be hard to justify why one provision would trigger an object analysis while the other would assess the effects of such a practice.

Indeed, AG Bobek has specifically addressed the point that the economic and legal context needs to be considered not only in relation to Article 101 TFEU but also in relation to Article 102 TFEU, citing *Michelin I, Post Danmark I*[87] and *Intel* in support, the latter ‘clarifying’ the position under *Hoffman-La Roche*:

> *“[T]he assessment of a practice under EU competition rules cannot be made in the abstract, but requires an examination of that practice in light of the legal and economic conditions prevailing on the markets concerned. The importance of this principle is confirmed by the fact that it has been found to be valid with regard to both Article 101(1) TFEU and Article 102 TFEU*”.[88]

The case law under Article 102 TFEU itself has slowly imported components of Article 101 TFEU. For example, in *Post Danmark I* and *Intel*, the EU courts reproduced *expressis verbis* the exoneration clause of Article 101(3) TFEU within Article 102 TFEU, suggesting a similar four pronged test applied for the evaluation of justifications brought forward by a dominant firm.

More fundamentally, there are three obvious parallels between Article 101(1) TFEU and Article 102 TFEU which strongly support a translation from the object / effects restriction dichotomy under Article 101(1) TFEU into an objects / effects dichotomy for Article 102 TFEU: (i) the "capability" standard developed by the courts under Article 102 TFEU has strong similarities with the test for object restrictions under Article 101 TFEU; (ii) the rationale for and presumptions underlying the different standards in both provisions are the same; and (iii) the ‘but for’ efficiency screen under Article 101(1) TFEU is reflected in a number of the Article 102 TFEU categories to which the capability standard is applicable. These three points are further explored in the remainder of this Section.

---

[87] Case C-209/10, *Post Danmark v Konkurrenceradet*, paras. 28-35 (”***Post Danmark I***”) .

[88] *AG Bobek Budapest Bank Opinion*, para. 46.

### 3.2 Capability standard and object abuses

The analytical framework developed by the ECJ for Article 102 TFEU abuses includes a "capability" standard (i.e. the court considers whether the impugned conduct is capable of foreclosing competitors). As we will demonstrate in more detail in the next two Sections, this framework in many ways mirrors the test which AG Bobek set out in *Budapest Bank* for Article 101 TFEU.

The 'object abuse' framework is neatly encapsulated by the ECJ in *Michelin I*:

> *"In deciding whether Michelin NV abused its dominant position in applying its discount system, it is therefore necessary to <u>consider all the circumstances</u>, particularly the <u>criteria and rules for the grant of the discount</u>, and to investigate whether, in providing an <u>advantage not based on any economic service justifying it</u>, the <u>discount tends to remove or restrict the buyer's freedom</u> to choose his sources of supply, to bar competition from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties or to strengthen the dominant position by distorting competition"* (emphasis added).[89]

Unpacking that framework reveals the key building blocks which we also see: first, the question is whether the type or category of unilateral conduct is harmful in nature (i.e. whether the discount "*tends to remove or restrict the buyer's freedom*"). In answering this question, the authorities are asked not only to assess the "*criteria and rules for the grant of the discount*" but also to consider all (other) circumstances. Finally, the framework also takes into account efficiency considerations ("*advantages based on any economic service justifying it*").

As we will show in more detail in **Sections IV** and **V**, there are however also noticeable differences between the object restriction, as set out in *Budapest Bank*, and the 'object abuses' as defined by the Focus Cases.

### 3.3 Presumption of object abuses

In addition to the similarities of the analytical framework for object restrictions and abuses which are subject to the capability standard, there are also strong parallels regarding the underlying presumptions.

As the CFI put it in *Michelin II*: "*If it is shown that the object pursued by the conduct of an undertaking in a dominant position is to limit competition, that conduct will also be liable to have such an effect*."[90]

The CFI illustrates that point by referring to *AKZO v Commission* where "*prices below average variable costs applied by an undertaking in a dominant position are regarded as abusive in themselves because the only interest which the undertaking may have in applying such prices is that of eliminating competitors*".[91]

However, at the same time, if the dominant firm can demonstrate that, given the market circumstances the above presumption of harm is not valid, then the capability standard may not be appropriate. An example is zero pricing by multi-sided platforms, which may be driven by efficiency considerations (namely to solve the 'chicken and egg problem' of multi-sided platforms and to get all sides on board) rather than an anticompetitive object.[92]

---

[89] *Michelin I,* para. 73.

[90] *Michelin II*, para. 241.

[91] *AKZO v Commission*, para. 72.

[92] Case HC-2013-000090, *Streetmap.EU Ltd v Google Inc. & Ors* [2016] EWHC 253 (Ch).

The parallels to Article 101(1) TFEU and the considerations by the courts in relation to multi-sided platforms, such as those in *Cartes Bancaires,*[93] are glaringly obvious.

### 3.4 The "but for" logic of object infringements

The underlying logic of the framework for object restrictions, as outlined by AG Bobek in *Budapest Bank,* is that an object approach is only suitable where the restriction imposed by the parties in question cannot be explained in any other way "but for" the anticompetitive object of the arrangement; in other words, there can be no other (plausible) explanation. By contrast, if the parties to the arrangements can adduce a plausible efficiency justification, an effects analysis is required.

The same "but for" logics has been applied in a number of cases in the context of Article 102 TFEU. The courts have considered conduct to be abusive (by object) on the basis that it could have no plausible purpose other than the elimination of competition. For example, in *Lithuanian Railways,* the incumbent railway operator dismantled 19km of railway track connecting Lithuania and Latvia.[94] The General Court found that the objective of this conduct was to prevent one of its major customers from using the services of a competitor. Rather than testing whether the conduct could be considered abusive under the essential facilities doctrine, the General Court held that *"[i]t was sufficient, subject to any objective justification, to show that the conduct in question was such as to restrict competition, and in particular, to constitute an impediment to market entry*".[95] A similar approach was taken in *Racal Decca* where the firm introduced changes in radio signals ("jamming") for the purpose of causing its rivals' products to malfunction.[96] After intervention by the EC, the firm agreed to abandon these practices.[97]

Finally, a third example which falls under the 'but for' logic is the *AstraZeneca*[98] case: as Colomo points out: "*Providing misleading information to a patent authority does not seem to serve any purpose other than the restriction of competition (via the extension of the protection)*".[99] Colomo cites the *Hoffmann-La Roche* ruling of 2018[100] in support of this proposition:

> "*If providing misleading information by means of an agreement is deemed to have as its object of the case, I fail to see how it would be possible to reach a different conclusion under Article 102 TFEU (and the analysis in AstraZeneca by the EU courts only confirms this point)*".[101]

93 Case C-67/13 P, *Groupement des cartes bancaires* EU:C:2014:2204.

94 T-814/17, *Lithuanian Railways v Commission*, EU:T:2020:545, para. 99 ("***Lithuanian Railways***").

95 *Lithuanian Railways*, para. 99.

96 Case 89/113/EEC, *Decca Navigator System*, 21 December 1988 ("***Racal Decca***").

97 Racal Decca Marine Navigation Limited Press Release IP/88/886, 22 December 1988, available at <https://ec.europa.eu/commission/presscorner/detail/en/IP_88_866>.

98 Case C-457/10 P, *AstraZeneca AB v European Commission*, ECLI:EU:C:2012:770 ("***AstraZenica***").

99 P Ibanez Colomo, "Persistent myths in competition law (V): 'there is no such thing as an abuse by object (or by effect) under Article 102 TFEU'", Chillin'Competition, 10 January 2020, available at < Persistent myths in competition law (V): 'there is no such thing as an abuse by object (or by effect) under Article 102 TFEU' | Chillin'Competition (chillingcompetition.com)>.

100 Case C-179/16, *F. Hoffmann-La Roche Ltd and Others v Autorità Garante della Concorrenza e del Mercato* ECLI:EU:C:2018:25.

101 Colomo, "Persistent myths in competition law (V): 'there is no such thing as an abuse by object (or by effect) under Article 102 TFEU'", Chillin'Competition, 10 January 2020, available at < Persistent myths in competition law (V): 'there is no such thing as an abuse by object (or by effect) under Article 102 TFEU' | Chillin'Competition (chillingcompetition.com)>.

## D. Economic building blocks for an effects-based analysis

This section considers what structural rules of reason may be developed based upon the economic literature covered in **Section III.B** above in order to facilitate an effects-based analysis of conditional rebates. Our presentation of the theories of harm shows that three broad categories emerge:

(i) predation, which is a dynamic theory of harm where foreclosure is followed by a recoupment;

(ii) theories of harm where customers are directly compensated for their exclusivity and where recoupment takes place simultaneously (naked exclusion with offer targeted at strategic customers is the simplest conceptual version of this theory of harm); and

(iii) theories of harm where customers are not compensated (or where there is no profit sacrifice in the first place).

We have shown that the plausibility of these theories of harm, and in turn, of potential pro-competitive justifications, will depend on specific market circumstances. For instance, it is more likely that schemes that significantly change customers' incentives to choose suppliers *ex-post*, correspond to pro-competitive rationales when the supplier sells non-standardised products that require significant specific investments and when renegotiation is unavoidable. Such conditions are not met in all markets and in all circumstances.

In the presence of established potential sources of pro and anti-competitive effects, it is perfectly understandable that different legal systems might choose slightly different legal standards depending on their aversion to type 1 or type 2 errors. It is, however, important that all legal systems rely on consistent principles, based on economic theory and experience. It is also important that the standards are fair and symmetrical. In particular, if presumptions of harm are wide and the legal standard is relatively easy to meet for enforcers, the efficiency of the legal system requires that the standard for rebuttals is equally open and transparent. In this sense, one could therefore consider that the legal standard of plausibility for pro-competitive rationales presented in **Section.III.C** is a natural counterweight to the existence of wide presumptions of harm in EU law.

In this Section, we review the main building blocks for a structured rule of reason which might correspond to the theories of harm presented above and facilitate an effects analysis. We do not cover predation, as – being clearly an "object" abuse – the legal and economic assessment of predation is conceptually simpler and clear principles are established and understood (i.e. that prices below short term (or marginal) costs are generally considered to be an abuse of dominance "by object"[102]). Nonetheless, the established rules in relation to predation provide a helpful benchmark for our approach. While the test does not correspond exactly to the predation theories of harm delineated by economic theory (for economists, predation is not *per se* related to below cost prices, but to short term profit sacrifice), it does correspond to the main mechanics and focuses on aspects at least positively *correlated* with most economic theories. It also focuses on the exclusion of at least as efficient competitors; as such exclusion is *more* likely to harm consumers. It is also a good rule because it is transparent and easy to administer. We therefore use this as a benchmark to assess how the two other classes of theories of harm could be translated into structural tests for evaluating the effects of conditional rebates, emphasising the relationship between the width of the presumption of harm and the fair standard for its rebuttal.

[102] *AKZO v Commission,* para. 71.

## 1 Theories of harm that require a significant direct profit sacrifice (naked exclusion)

We turn first to the issue of foreclosure through various forms of individualised rebates. Whether based on exclusivity, growth targets or volumes, the important aspect for the purpose of this theory of harm is that the rebate is offered to some (if successfully executed, strategic) customers, but not all customers (i.e. the dominant supplier does not need to reduce its prices to all customers). What criteria that is equivalent to that used for predation could be used according to our framework to delineate, at least as a first pass, whether this theory of harm is particularly likely? The theory itself was actually developed with naked exclusivity in mind. Consequently, this theory of harm relies on the existence of some benefit to the customer which *induces* it to procure exclusively from the dominant supplier. The form of such inducement (incremental or with discontinuities, *ex ante* or *ex post*, individualised or standardised) is not directly relevant to the likelihood of the theory of harm being established (though it may become *indirectly* relevant if (i) they were at least *negatively correlated* with features that made procompetitive rationales more or less likely; or (ii) they were *positively correlated* with features that makes this theory of harm more likely).

The theory of harm (corresponding to the second, more plausible version of the naked exclusion theory outlined in **Section III.B** above) is rather straightforward and rests on two main pillars:

(i) the rebates or discounts targets customers that are particularly strategic for competitors to enter or expand; and

(ii) the strategic customers need to receive a sufficiently large inducement to voluntarily participate in the scheme.

The question of individualisation identified in the case law is therefore indirectly relevant. However, it is not the fact that thresholds or nominal rebates / discounts are individualised that is important. Rather, what is significant is that some actors receive substantially larger inducements than others. Moreover, these customers need to be strategic for competition to develop in the market. Last, the inducements they receive need to be “significant”. Typically, the dominant company needs to compensate the loss that this strategic consumer would gain from more open competition (i.e. the dominant company pays a foreclosure premium). This last factor is important to differentiate a situation where customers with more bargaining power simply get a “better deal” from a situation where they are bribed to prevent entry or expansion.

For this reason, as for low prices, it is necessary to find a robust criterion to qualify whether an inducement is significant or not or, in other words, whether these strategic customers get too good a deal. This criterion would also ideally need to identify the types of non-linear prices that are unlikely to be associated with pro-competitive rationales. As for predation, different legal systems might choose slightly different rules depending on agencies’ priors and experience, as well as on their balancing of type 1 and 2 errors. However, the building blocks should be similar and when presumptions are wide, standards for rebuttals have to be equally clear, wide and fair.

The question in this context is whether one can trust the shape of the non-linear prices to design such a rule. As made clear earlier, what directly matters for the theory of harm is the magnitude of the inducement, not the shape. The case law in Europe seems to have considered that the existence of a discontinuity in the tariff meant that the inducement was more likely to be “significant”, at least locally (a discontinuity in the tariff necessarily means negative prices, at least formally and locally). However, this discontinuity could be relatively small and a point in customers’ demand that does not lead to any real suction effects for competitors. Conversely, well-targeted and significant discounts can have real effects.

On balance, there exist small rebates and large discounts, and it seems difficult to argue that one type of linear price fits more squarely within this theory of harm (which was initially written with exclusive contracts in mind). By the same token, while some types of efficiencies require different types of non-linearities, all types of tariffs could correspond to some types of efficiencies.

In fact, likelihood of harm and plausibility of procompetitive rationales are multidimensional and sit on a sliding scale. For this reason, it is very difficult to find types of prices that are entirely safe (and this is the reason why the case law does not provide strong guidance on what is safe from a compliance perspective). It is also very difficult to find types of non-linear prices that cannot be justified by procompetitive rationales under certain circumstances.

Therefore, it is difficult to really trust the formal characteristics of the rebate. The alternative is to directly assess the magnitude of the inducements provided by the rebates. In the same way as it is difficult to determine whether prices are large or small in the abstract when assessing predation, it is difficult to assess whether a rebate or a discount is large or small without any reference to a relevant benchmark. The EC considered that such a relevant benchmark would be to compare the rebate or discount at risk with the margin that a competitor that is at least as efficient would make for a realistic order. Such an order could differ from the total demand of particular customers for various reasons (i.e. the demand is not entirely contestable).

This approach forms the basis of the structured rule of reason described in the Priorities Guidance (with the assessment of the strategic nature of the customers covered by the tariff).[103] As for predation, this approach does not perfectly match the theories of harm. It is however directly correlated with factors that matter for the theory of harm. For this reason, such an approach also seems relevant to assess any form of exclusion that requires a significant inducement (i.e.; whenever consumers need to be directly compensated for the exclusivity).

## 2 All other theories of harm that do not require a significant direct profit sacrifice

The AEC based approach set out above might not, however, be the most effective test to assess any of the other types of theories of harm where strong direct inducements are not necessary. This can be the case, for instance, because foreclosure emerges due to a lack of coordination between buyers, or because any benefit of entry could be dissipated by downstream competition. These theories are more challenging to assess. They could, by definition, emerge in the presence of inducements, which could, purely on the basis of their magnitude, appear benign.

To put it differently: these theories of harm have sometimes been used by enforcers to justify very strict and wide prohibitions. Such an approach does not correspond to the economic framework set out in **Section III.B**, because as we have shown, the likelihood of these theories of harm being established cannot be assumed in all circumstances.

In fact, all the theories of harm that can lead to anticompetitive foreclosure on the basis of “small” inducements rely on assumptions that can be identified and tested. First, if one believes that customers do not need to be compensated for exclusivity because the benefits stemming from upstream competition would be dissipated by downstream competition, one should be able to find traces of such beliefs in customers’ internal documents. Second, foreclosure is more likely to emerge with rebates that cover a large share of the total demand, whether they are set on an individual or standardised basis. These two assumptions provide two potentially useful screens: whether

[103] Priorities Guidance, para. 20 et seq.

customers' internal documents evidence a view that upstream competition will not deliver benefits, and whether the rebates cover a large share of total contestable demand.

Most of these theories also rely on a very strong form of commitment to the tariff (i.e. they would not hold in cases where customers can easily renegotiate). Such commitment is more likely to be present in some market circumstances than in others, but it is difficult to identify a clear structural rule of reason to evaluate whether this is the case in a given market. An assessment of such theories of harm therefore necessarily requires an analysis of "all the circumstances".

# IV. THE FOCUS CASES AND THE EVOLUTION OF THE LEGAL APPROACH TO REBATES

The EC and EU courts' approaches to assessment of conditional rebates can be considered to fall into three broad "eras" (these eras are specific to conditional rebates under Article 102 TFEU and do not form part of a coherent approach across all enforcement under Article 102 TFEU[104]). In the first era, early cases, including *Michelin I*, established the principle that quantity rebates are generally permissible, while fidelity rebates (covering exclusivity rebates and target rebates) are generally not. In *Michelin I*, the Court took pains to point out that to assess whether a rebate was fidelity-inducing, all circumstances needed to be taken into account, including the relative market position of the dominant firm and its competitors. In the second era – where *BA/Virgin* and *Michelin II* fall – this approach was "toughened", so that more kinds of rebates were considered to fall within the "fidelity" category; the by object approach to the assessment of rebates was entrenched and more emphasis was put on the formal characteristics of the rebates. Finally, in the third era, in the period since *Michelin II* and *BA/Virgin*, the framework for conditional rebates has shifted from an object approach to an effects approach. This shift was set out in the Article 102 TFEU Priority Guidance, which acted as a catalyst for a greater emphasis on likely effects. It has since then also been reflected in the case law, most recently in the Court's decision in *Intel*.

Below, we summarise the evolution of approach to rebates in EU competition law through the lens of the Focus Cases. In all three Focus Cases, while the core anticompetitive harm identified related to the loyalty-inducing effects of the rebate scheme in question, the EC and EU courts also made findings that the rebate schemes were variously discriminatory, unfair and/or had a market partitioning effect. These "non-core" effects of the rebates were in all cases closely linked to the loyalty-inducing nature of the scheme. Indeed, in *Michelin II* the CFI found that a loyalty-inducing rebate system had foreclosure effects regardless of whether it was discriminatory.[105] The CFI also acknowledged that "*the alleged unfairness of the system was closely linked to its loyalty-inducing effect [and that]… it must be held that a loyalty-inducing rebate system is, by its very nature, also partitioning, since it is designed to prevent the customer from obtaining supplies from other manufacturers*".[106] This paper, therefore, focuses on the EC and EU courts' findings in relation to the loyalty-inducing nature of the rebate schemes.

## A. *Michelin I*: early consideration of the fidelity / quantity rebate distinction

### 1 Background

In 1975, *Suiker Unie*[107] first established the principle that quantity rebates are generally considered not to give rise to foreclosure effects and are therefore presumptively *lawful*; and by contrast, fidelity (or fidelity-inducing) rebates typically lead to foreclosure and are presumptively *unlawful*. *Sukier Unie* considered numerous restrictions imposed by various sugar producers under Articles 101 and 102 TFEU. Most critically for current purposes, the case considered a rebate granted by SZV (a sugar producer), which was expressly tied to exclusivity. There was clear evidence of the rebate being

[104] For example, while *BA/Virgin* and *Michelin II* sit in the second, formalistic, era, other cases at the same time adopted an effects-based approach: e.g. Case T-65/98, *Van den Bergh Foods v Commission*, in which the CFI's judgement was delivered just a month after the CFI judgement (of a differently constituted chamber) in *Michelin II*, on 23 October 2003,

[105] *Michelin II*, para. 65.

[106] *Michelin II*, para. 66.

[107] Case C-40/73, *Cooperatieve Vereniging Suiker Unie UA v Commission of the European Communities* EU:C:1975:174 ("***Suiker Unie***").

removed when SZV became aware that a customer had purchased from an alternative supplier. The EC reasoned that because customers were dependent on SZV for at least a certain portion of their supplies, it would quickly become uneconomic for them to purchase from any alternative suppliers. Further, SZV had a good insight into this because it could estimate the average volumes purchased annually (which did not change significantly). The rebate was therefore found to further consolidate SZV's already dominant position.[108] Part of the EC's criticism of the rebate was that it "*does not depend on the amount bought*",[109] thus, the distinction between quantity-based and loyalty rebates was born – in the context of a rebate explicitly dependent on exclusivity. These findings were endorsed by the ECJ.[110]

The principle that rebates dependent on exclusivity infringe Article 102 TFEU was upheld and formalised in *Hoffmann-La Roche*. Like *Suiker Unie*, the case dealt with a system that was – for the most part – explicitly dependent upon customers obtaining all their supplies from Roche. The "fidelity rebate" (as the EC referred to it) was one mechanism for ensuring exclusivity which existed in many of Roche's customer contracts. The ECJ's focus was very much on the link with exclusivity, finding that:

> "*obligations… to obtain supplies exclusively from a particular undertaking, whether or not they are in consideration of rebates or of the granting of fidelity rebates intended to give the purchaser an incentive to obtain his supplies exclusively from the undertaking in a dominant position, are incompatible with the objective of undistorted competition within the Common Market… The fidelity rebate, unlike quantity rebates exclusively linked with the volume of purchases from the producer concerned, is designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers*".[111]

However, in addition to the fixed rebates considered, which were explicitly dependent upon exclusivity, *Hoffman-La Roche* also looked at rebates which were applicable at progressive rates (generally from 1-3%) based on the volume purchased. The ECJ found that although such rebates appeared *prima facie* to be based on quantities rather than fidelity:

> "*an examination of them however shows that they are in fact a specially worked out form of fidelity rebate*"[112] as they were "*not dependent on quantities fixed objectively and applicable to all possible purchasers but on estimates made, from case to case, for each customer according to the latter's presumed capacity of absorption, the objective which it is sought to attain being not the maximum quantity but the maximum requirements*".[113]

These rebates were therefore also considered illegal, and this finding laid the groundwork for the assessment that followed in the Focus Cases.

*Michelin I* came just six years after *Suiker Unie,* in 1981,[114] and built directly on the law established in *Hoffman-La Roche*. *Michelin I* therefore itself became key in this early development of the law on rebates, as summarised in depth below.

---

[108] *Suiker Unie*, page 1689.

[109] Case 73/109/EEC, *European Sugar Industry*, 2 January 1973 ("***Suiker Unie (EC)***"), page 39.

[110] *Suiker Unie*, page 2005.

[111] *Hoffmann-La Roche*, para. 90.

[112] *Hoffmann-La Roche*, para. 98.

[113] *Hoffmann-La Roche*, para. 100.

[114] *Michelin I (EC)*.

# 2 *Michelin I*

## 2.1 Conduct under scrutiny

*Michelin I* considered a rebate system operated by Michelin NV for tyre dealers. The rebate system had various components, most (but not all) of which were target rebates.

First, the "invoice discount" was granted to all dealers on each invoice. The invoice discount was at a fixed rate for all dealers, announced through a circular at the beginning of each calendar year.

In addition, various further “bonuses” were available. The rebates were linked to the individual dealers increasing (or in a difficult economic situation, maintaining) purchases from Michelin NV, the estimated sales potential of the dealer, and the share of Michelin NV tyres in the dealers' sales (referred to as "temperature Michelin"). In general, the targets (the number of which differed over time) were fixed in such a way that the target level was higher than the corresponding purchases in the previous year (though the discount did not increase). This meant that the rebate was tied to sales growth. The periods over which the bonuses were calculated varied over time from annual, to a monthly advance on the annual bonus and to a monthly and then four-monthly bonus. These “bonuses” were generally informally negotiated with dealers without written confirmation. Michelin NV's internal documentation showed a large degree of variation in the invoice discounts and bonuses paid to its dealers and that they were set in an *ad hoc* manner.

Separately, the case also considered an extra bonus of 0.5% granted in 1977, which was contingent on a certain target being achieved on the sale of light tyres. This was a one-off rebate offered at a time when Michelin NV was unable to meet demand for heavy tyres and wanted to stimulate demand for light tyres. There was also a 2% “cash discount” available for payments made in accordance with the agreed terms.

## 2.2 Market definition and assessment of dominance

The EC considered the relevant market to be the market for new replacement tyres for trucks and buses in the Netherlands. Michelin NV’s dominant position was considered apparent from its large market share compared to that of its competitors.

In its dominance assessment, the EC noted that Michelin NV had the highest market share in the European Economic Community and the second highest worldwide. Goodyear held the highest. Between 1975 and 1980, Michelin NV’s share of the market for new truck and bus tyres in the Netherlands was between 57% and 65%, while competitors’ market shares were between 4% and 8%. Goodyear was not considered to exercise any competitive pressure on the Dutch market (although the EC did not cite any evidence to support this, such as analysis of import-export flow or trade barriers). The EC found that consumers had a strong preference for Michelin NV’s tyres and were loyal to its products because of perceived reliability and quality. This was considered an important determinant of Michelin NV’s dominance. The ECJ similarly emphasised that Michelin NV was the only supplier on the market for certain tyres and that a dealer established in the Netherlands normally could not afford not to sell its tyres.

The EC also relied upon the rebate system to support its finding of dominance, stating that the "*system is of such a nature that it can only be practiced by an enterprise in a dominant position*"[115] and that dealers would never accept this system imposed by other manufacturers (who generally

[115] *Michelin I (EC)*, para. 48.

offered only an invoice discount, but at a much higher level than Michelin NV's, sometimes supplemented by an end of year bonus of a few per cent).[116]

## 2.3 Legal test to establish abuse

### 2.3.1 Application of the existing *Suiker Unie* / *Hoffmann-La Roche* framework

In *Michelin I* the legal test applied was whether the rebate system represented a "fidelity" or "quantity-based" system. The ECJ drew a distinction between a quantity rebate "*which is linked solely to the volume of purchases from the manufacturer concerned*"[117] and a fidelity rebate "*which by offering customers financial advantages tends to prevent them from obtaining their supplies from competing manufacturers*",[118] the latter of which was clearly illegal, referring to established law from *Suiker Unie* and *Hoffman-La Roche*.

However, the ECJ was unable to neatly slot Michelin NV's rebate system into either the quantity or fidelity categories, noting that while it was not a "*mere quantity discount*",[119] it also "*did not require dealers to enter into any exclusive dealing arrangements or to obtain a specific proportion of their supplies from Michelin NV*".[120]

*Michelin I* demonstrates the limited flexibility and direct applicability of the "fidelity rebates" / "quantity rebates" framework. The EC argued that Michelin NV's target-based rebates were akin to exclusivity rebates as defined in *Hoffmann-LaRoche*, saying that "*a system based on annual targets puts strong pressure on the dealer to obtain his supplies from the same supplier because of the dealers' uncertainty as to the rates of discount and the risk of losing some of the discount if the sales target is not attained*".[121] In response, Michelin NV denied that dealers are dependent upon it and that the purpose of the system is merely to "*reward the purchase of increasing quantities of goods*".[122]

### 2.3.2 Development of a new legal framework for assessment of "target discounts"

The ECJ, therefore, found that it was "*necessary to consider all the circumstances, particularly the criteria and rules for the grant of the discount, and to investigate whether, in providing an advantage not based on any economic service justifying it, the discount tends to restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market*".[123] Unpacking this framework reveals the following building blocks for both assessment of harm and efficiencies.

With respect to assessment of harm, the test is outlined as to whether "*the discount tends to remove or restrict the buyer's freedom to choose his source of supply or to bar competitors from access to the market*".[124] In other words, the question the ECJ posed is whether the rebate falls within a category of rebates that can be expected to (or "tends to") have a harmful impact on competition (namely to remove or restrict the buyer's freedom to choose his sources). In answering this question, the ECJ makes clear that it is necessary, first, to assess the criteria and rules for the grant of the

[116] *Michelin I (EC)*, para. 22.

[117] *Michelin I*, para. 71.

[118] *Michelin I*, para. 71.

[119] *Michelin I*, para. 72.

[120] *Michelin I*, para. 72.

[121] *Michelin I*, para. 78.

[122] *Michelin I*, para. 79.

[123] *Michelin I*, para. 73. The framework continued "*to apply dissimilar conditions to equivalent transactions… or to strengthen the dominant position by distorting competition"*, but these potential harms are not considered in depth in this paper.

[124] *Michelin I*, para. 73.

rebate; and subsequently to consider all other circumstances. With respect to assessment of efficiencies, the test is whether the rebate provides an advantage based on "*any economic service justifying it*".[125]

## 2.4 Assessment of foreclosure harm

### 2.4.1 Rebates tending to harm competition

**Criteria and rules for the rebate system**: The EC assessed the various criteria and rules for the rebate system. First, it considered the target nature of the rebate. The EC considered that the rebate system was clearly aimed at putting strong pressure on the dealer to sell more Michelin tyres each year than the previous year, noting, in particular, the fact that targets were set "*individually and selectively*" for each dealer.[126] The EC considered that the pressure was increased through regular visits made by Michelin NV representatives to dealers to check that targets were being reached (i.e. the "temperature Michelin"), and the lack of transparency in relation to the rebate.[127]

The size of the rebate was also considered. Michelin NV raised the point that the size of the rebate was only limited. This was rejected by the EC, which found "*it is well known in the tyre trade that each percentage point more or less can play a critical role for the dealer's profitability*".[128] It was similarly rejected by the ECJ on the basis of other existing factors discussed below (e.g. length of reference period and retroactive effect).

Both the EC and the ECJ considered the retroactive effect coupled with the length of the reference period (annual) to have important implications in terms of its effect on dealers. The ECJ makes the point 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 the discount or to avoid suffering the expected loss for the entire period*".[129]

**All (other) circumstances**: The EC and the ECJ were at pains to emphasise the relevance of wider market conditions for the analysis. Two factors were considered important when arriving at their ultimate conclusion that the rebate scheme had abusively bound dealers to Michelin NV.

First, the wide divergence between Michelin NV's market shares and those of its main competitors was considered important. The ECJ noted that other dealers would have to make up the largest absolute value of Michelin's annual target rebate over a much smaller volume of sales, in order to have an offer that could induce dealers *not* to meet their targets with Michelin NV.[130]

Second, the lack of transparency of Michelin's entire rebate system, which also changed on several occasions, and the fact that neither the scale of the sales targets nor the rebates relating to them

[125] *Michelin I,* para 73.
[126] *Michelin I (EC)*, para. 37.
[127] *Michelin I (EC)*, para. 38.
[128] *Michelin I (EC)*, para. 43.
[129] *Michelin I*, para. 81.
[130] *Michelin I*, para. 82.

were communicated in writing. The ECJ (like the EC) found that this made it difficult for the dealers to predict with any confidence the effect of attaining their targets or failing to do so.[131]

**Object assessment regarding foreclosure**: In light of the above factors, the EC and the ECJ concluded that dealers were under considerable pressure, especially towards the end of the year, to attain Michelin NV's sales targets.[132] The ECJ found that the overall system was calculated to prevent dealers from being able to "*select freely at any time in light of the market situation the most favourable of the offers made by the various competitors and to change suppliers without suffering any appreciable economic disadvantage*"[133] and therefore constituted an abuse of dominance.[134]

## 2.5 Assessment of efficiencies

The assessment of efficiencies in *Michelin I* can fairly be described as minimalist. As mentioned at **Section IV.A.2.3.2** above, the type of efficiencies to be taken into account is defined very narrowly (i.e. such that efficiencies are only relevant to the extent that the rebate provides an advantage based on any economic service justifying it).[135] The Court does not expand on this further. It distinguishes the rebate system in question from a mere volume discount, suggesting that a volume efficiency rationale may be accepted but provides no guidance on how such a discount or efficiency would be measured.

In any event, Michelin NV put forward two efficiency justifications. First, that the rebates were intended to lead to greater sales (though the classification of this argument as an efficiency justification is questionable). Second, and more clearly, that the rebates enabled Michelin NV to better plan its production. On the latter, Michelin NV also argued that the lack of official statistics in the Netherlands during 1975-1980 required the company to estimate sales through its customers, resulting in frequent meetings to measure dealers' "temperature Michelin" and that such rebate schemes allowed them to plan their supply to the dealers.

Both efficiency defences got short shrift, with the ECJ finding that "*neither the wish to sell more nor the wish to spread production more evenly can justify such a restriction of the customer's freedom of choice and independence*".[136]

## 2.6 Conclusions

*Michelin I* saw the EC, and later the ECJ, take a relatively cautious approach to fidelity rebates. Although the test was articulated as one of capability, the ECJ did consider the practical effect of the rebate system on the dealers in some detail.[137] While *Michelin I* ultimately concluded that the rebate scheme sat within the prohibited "fidelity rebate" category established in the earlier cases, it did so only after analysing the conduct as well as the market circumstances as set out above. Hence, the ECJ looked at not only the form of the arrangement (albeit there was minimal consideration of the plausible justifications for the conduct and the ECJ's assessment of the likely effect of the behaviour does not correspond to modern economic thinking).

[131] *Michelin I*, para. 83.

[132] *Michelin I*, para. 84.

[133] *Michelin I*, para. 85.

[134] *Michelin I*, para. 86.

[135] *Michelin I,* para. 73.

[136] *Michelin I*, para. 85.

[137] *Michelin I,* paras. 82-84.

As discussed further in **Section V.B**, the legal framework set out for assessing harm has similarities with the one established by AG Bobek in *Budapest Bank* (i.e. identification of a category based on formal criteria which is vetted by considering all circumstances). By contrast, the assessment of efficiencies differs significantly: (i) the efficiencies are defined very narrowly (arguably so narrowly that they would never apply to target rebates); and (ii) the standard of proof is far higher than the plausibility standard articulated in *Budapest Bank*.

Neither the EC nor the ECJ articulated a specific economic theory of harm in this case (nor assess the impact on end consumers or plausible pro-competitive rationale). Highlighting the divergent market shares between Michelin NV and its competitors, and the implications of this for competitors seeking to match Michelin NV's offer, could be equated with a crude and nascent form of the AEC test. However, no economic analysis of competitors' prices was conducted. Instead, the EC found: (i) the restriction of the tyre dealers' "freedom of choice"; and (ii) the "inequality of treatment" between tyre dealers as problematic in themselves.[138] The former had "restricting effects on competition" and the latter "discriminatory effects" (the ECJ's assessment of discriminatory effects is secondary and is not a focus of this paper).[139] Whilst the ECJ dismissed the EC's latter contention, it upheld the former on the basis that, by effectively "*binding dealers […] to itself*", Michelin NV committed an abuse.[140]

## B. *BA/Virgin and Michelin II era – entrenchment of the by object approach*

### 1 Background

In the cases that followed *Michelin I*, the EC and EU courts expressed a clear preference for concentrating on the form of rebate schemes, rather than engaging in any substantive inquiry into the specific effects that these schemes might have on the ability of competitors to compete or on the plausible procompetitive rationale for these practices. Where rebate schemes could be identified as capable of inducing loyalty, they were regarded as effective by object infringements of Article 102 TFEU.

The view that many forms of rebates (and in particular, target rebates) were capable of restricting competition became entrenched. Unlike in *Michelin I*, the specific conduct and context were not analysed in the same level of detail. This was seen in various EC decisions made at the time. For instance, in *Deutsche Post*,[141] the EC considered a fidelity rebate policy for mail-order parcel services and noted that it was "*settled European case-law that rebate arrangements which are linked to meeting a percentage of customer requirement have…an anticompetitive tying effect*"[142] and rejected the need to demonstrate the anticompetitive effects of such rebate schemes.

A similar approach had been taken by the EC in *BA/Virgin* and *Michelin II*, and the CFI endorsed the principle in both cases:

- In *BA/Virgin*, the CFI held that "[…] *it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct of the undertaking in a dominant position tends to*

[138] *Michelin I (EC)*, para. 37.

[139] *Michelin I (EC)*, para. 56.

[140] *Michelin I*, para. 86.

[141] Case 2001/354/EC, *Deutsche Post AG*, 20 March 2001 ("***Deutsche Post (EC)***").

[142] *Deutsche Post (EC),* para. 39.

*restrict competition, or, in other words, that the conduct is capable of having, or likely to have, such an effect*".[143]

- In *Michelin II*, the CFI held that "[…] *establishing the anti-competitive object and the anti-competitive effect are one and the same thing* […]. *If it is shown that the object pursued by the conduct of an undertaking in a dominant position is to limit competition, that conduct will also be liable to have such an effect*".[144]

In many respects *BA*/*Virgin* and *Michelin II* can be viewed as the "high water mark" for the object-based approach to assessment of conditional rebates. Each case is summarised in detail below.

## 2 *BA/Virgin*

### 2.1 Conduct under scrutiny

In 1993, Virgin lodged a complaint against BA, alleging that certain commercial practices discount structures were incorporated in agreements between BA and its travel agents. Travel agents in the UK received a standard commission from BA which, between 1976 and 1997, was 9% for international sales and 7.5% for domestic sales. In 1998, Virgin lodged a supplementary complaint in relation to a performance reward scheme introduced in the previous year.

Virgin's complaint concerned the introduction of additional incentive schemes to supplement the standard commission for certain qualifying agents. Marketing agreements were offered to agents in the UK who received additional bonuses, calculated on the basis of a comparison between BA tickets purchased in the UK in the previous year, compared with the current year's sales. The reward was linked to the extent to which a travel agent increased the value of their sales for BA tickets, with different scales depending on the type of sector flown.

Similar global agreements were introduced for three travel agents with respect to their world-wide sales. These were in addition to local agreements in particular countries. If the agent achieved a minimum of 1.5% increase in their overall sales, BA rewarded the agent with 10% of the incremental revenue. The global agreements were based on a quarterly reference period.

Finally, the performance reward scheme, introduced in 1997, supplemented the standard commission, offering agents up to 3% for international tickets and 1% for domestic tickets for agents who sold more BA tickets in the UK in the current month than in the previous month.

The schemes were target rebates. In each case, meeting the target led to an increase in commission or cash reward paid on all tickets. Virgin alleged that these were "requirement contracts" in breach of Article 102 TFEU and were just attempts by BA to foreclose the market for air travel to and from the UK from its competitors.

### 2.2 Market definition and assessment of dominance

The relevant markets considered were those for air travel agency services in the UK and passenger air transport to and from the UK.

The EC found that BA was the dominant purchaser on the UK market for travel agency services.[145] This arose from its dominance in the markets for air travel and, more specifically: (i) its structural

[143] *BA/Virgin (CFI),* para. 293.

[144] *Michelin II*, para. 241.

[145] *BA/Virgin (EC)*, para. 90.

position of offering the largest selection of flights in and out of the UK; (ii) its share of total sales of air travel in the UK (and hence its share of the purchases of air travel agency services); (iii) its share of the markets compared to its competitors; and (iv) the fact that this made BA the "obligatory business partner" for travel agents.[146]

The EC noted that, while competing airlines did have alternatives to purchasing air travel agency services from travel agents (e.g. sales by telephone and the internet), these were effectively "in-house" production of agency services. Travel agents at the time accounted for 85% of air travel sales and BA's abusive conduct had serious effects on competing airlines and potential new entrants, harming competition in general.

However, it must be noted that over the course of the infringement, the UK airline market became more competitive (in particular, with the entry of Virgin, which, on some routes, outsold BA), and, by the conclusion of the abuse, BA's market share was only 39%. This reflected BA's substantial losses due to the increased presence of competitors. However, the CFI found that neither the decline in BA's ticket sales nor the advance in market share of certain rival competitors was sufficiently large to call into question BA's dominant position.[147] In particular, the CFI noted the substantial gap that existed between BA and its competitors' market shares and the fact that BA's position remained "preponderant".[148]

### 2.3 Legal test to establish abuse

The ECJ in *BA/Virgin* referred to the legal frameworks set out in *Hoffmann-La Roche* and *Michelin I.* In particular, it reiterated the analytical building blocks developed in the latter.[149] The ECJ also clarified and refined – and, in some respects, diverged from – the legal framework of the earlier cases.

First, the ECJ emphasised the fact that certain types of rebates granted by dominant firms, including exclusivity rebates (*Hoffmann-La Roche*) and target rebates, are to be assessed within the framework of an object abuse (i.e. that "*it cannot be inferred from* [*Hoffman-La Roche* and *Michelin II*] *that bonuses and discounts granted by undertakings in a dominant position are abusive only in the circumstances there described*" but that "*the decisive factor is rather the underlying factors which have guided the previous case-law…and which can also be transposed to a case as the present*".[150] The ECJ framed the question as being whether "*the bonus scheme at issue had a fidelity-building effect capable of producing an exclusionary effect*").[151]

Second, while the ECJ clearly stated that it is necessary to consider "all the circumstances",[152] the factors considered were relatively few. Unlike in *Michelin I*, the CFI did not consider the duration of the reference period nor the size of the rebate, and in consideration of broader circumstances, focused only on BA's relative market share.[153] Thus, the range of circumstances considered was more limited than in *Michelin I*.

[146] *BA/Virgin (EC)*, paras. 91 - 92.
[147] *BA/Virgin* (*CFI),* para. 223. The question of BA's dominance was not considered by the ECJ.
[148] *BA/Virgin* (*CFI),* para. 224.
[149] *BA/Virgin,* para. 67, referring to *Michelin I.,* para. 73.
[150] *BA/Virgin,* para. 64.
[151] *BA/Virgin,* para. 77.
[152] *BA/Virgin*, para. 67.
[153] *BA/Virgin* (*CFI)*, para. 277.

Third, and contrary to *Michelin I*, the ECJ in *BA/Virgin* set out, in far greater detail, the relevance and criteria for any efficiency defence. The ECJ started with the position that "*only discounts or bonuses which are not based on any economic counterpart to justify them must be regarded as an abuse*".[154] It then established a balancing test between the (presumed) harm to competition and the (actual) efficiency benefits. The ECJ stated that it must be "*determined whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer*".[155] Finally, the ECJ made clear that efficiencies cannot be taken into account where the exclusionary effect of the rebate bears no relation to advantages for the market and consumers or where it goes beyond what is necessary in order to attain those advantages.[156]

Again this framework bears similarity to AG Bobek's object restriction analysis under Article 101(1) TFEU in *Budapest Bank*, particularly in relation to the assessment of competitive harm (i.e. identification of a category of rebates which 'tends to be harmful' on the basis of an assessment of the criteria of the rebates / bonuses and all (other) factors). As with abuse restrictions, it is open to the defendant to show that the conduct in question is not capable of restricting competition.

However, when it comes to the assessment of efficiencies, there is significant divergence between the framework in *BA/Virgin* and that set out by AG Bobek in *Budapest Bank*. This is most obvious in relation to the link between harm and efficiency and, by implication, the relationship between an object and an effects restriction / abuse. We will come back to this point in **Section V.A.2** below.

### 2.4 Assessment of foreclosure harm

In relation to the criteria and rules for applying the rebate, as in *Michelin I,* the ECJ highlighted that granting the rebate is "*linked to the attainment of sales objectives defined individually*"[157] and emphasised the retroactive nature of the rebates.[158]

In its analysis, the CFI focussed on the progressive nature of the performance reward scheme which it concluded had a very noticeable effect at the margin and that "*once the agent approached the benchmark for additional commission, the marginal commission which it earned on every additional BA sector sold increased exponentially*".[159] Moreover, the commission rates themselves "*were capable of rising exponentially from one reference period to another, as the number of BA tickets sold by agents during successive reference periods progressed*".[160]

When considering factors beyond the structure of the rebate scheme itself (i.e. "other circumstances"), the CFI referred only to the fact that BA's sales invariably represented a multiple of those of its five main competitors,[161] meaning that BA's competitors were not in a position to grant similar advantages to travel agents.

The EC (and ultimately, the ECJ) found that the payments made by BA under the scheme were fidelity-building, and a means of rewarding loyalty by increasing marketing and ticket sales.

[154] *BA/Virgin,* para. 84.
[155] *BA/Virgin,* para. 86.
[156] *BA/Virgin,* para. 86.
[157] *BA/Virgin,* para. 71.
[158] *BA/Virgin,* para. 73.
[159] *BA/Virgin* (*CFI),* para. 266.
[160] *BA/Virgin* (*CFI),* para. 272.
[161] *BA/Virgin* (*CFI),* para 277.

### 2.5 Efficiency considerations

BA argued that it was economically justified in rewarding travel agents that allowed it to increase sales and help cover its high fixed costs by bringing additional passengers (due to the importance of high aircraft occupancy rates). BA also put forward evidence that there might be some cost savings for BA in selling its tickets through an agency that generates a large volume of business. BA further argued that operational costs (e.g. query processing, production and checking reports, distribution of fare information) could be reduced due to economies of scale and that cost savings could be realised on commercial costs.

However, as outlined above, the framework used for evaluating efficiencies required, as a first step, that the putative efficiencies would bear a close relationship to the purportedly restrictive conduct and would not go beyond what was necessary. The EC found that this was not the case: it noted instead that the commission schemes in question did not respond to the different volumes of sales, or levels of service, provided by travel agents to BA.[162] Rather, the commission was linked to the extent to which the agent met or exceeded its previous year's sales.

The CFI considered that because the increase in commission rates applied to the total number of tickets sold and not only the extra ones once the targets were met, the agents' additional remuneration was not related to the BA-claimed efficiency gains from the sale of the extra air tickets.[163] The ECJ upheld the conclusion that BA's scheme did not appear to be based on any economically justifiable consideration (albeit without considering the detail of the justifications put forward, which it considered to be a question of fact). Because BA's alleged efficiencies failed this first threshold test (namely that efficiencies put forward were not of a kind that can be taken into account), the EC did not conduct a detailed balancing exercise of the pro and anticompetitive effects of the commission scheme.

### 2.6 Conclusions

As outlined above, the analysis in the original EC decision is rather cursory – it essentially reiterates the law stated in *Michelin I* and *Hoffmann-La Roche* before asserting that the "*commission schemes set out above are clearly related to loyalty rather than efficiencies*".[164] The review of "all circumstances" other than the characteristics of the rebate scheme (i.e. the review of market factors such as the supply structure) is perfunctory and falls short of the efforts undertaken in *Michelin I*. While more thought is given to efficiency considerations than was the case in *Michelin I*, the substantive engagement with the arguments is nevertheless limited, given the narrow scope of "admissible" efficiencies.

Neither the EC nor the EU courts articulated the specific economic harm in this case nor assessed the impact on end consumers. The EC and the EU courts explicitly stated that BA's rebate scheme had an exclusionary effect, but, as in *Michelin I*, neither assessed the contestable and non-contestable shares of demand as dictated by a modern economic approach.

This represents a significant hardening of the line taken in respect of target rebates. The EC and EU courts concentrated on outlining the form of the rebate scheme to effectively conclude that it is a by object restriction.

---

[162] *BA/Virgin (EC)*, para. 110.

[163] *BA/Virgin (CFI)*, paras. 283-284.

[164] *BA/Virgin (EC)*, para. 102.

# 3 *Michelin II*

## 3.1 Conduct under scrutiny

*Michelin II* considered a complex rebate system administered by Michelin France. The principal bonus was a retrospective retroactive quantity rebate, structured as an annual refund calculated as a percentage of turnover achieved at a gradually increasing rate, according to the quantities purchased, by each dealer (the "**Quantity Rebate**"). The payment of the rebate was made on all sales achieved in the relevant reference period, not just on a tranche of incremental sales. In addition, rebates were provided for the "*quality of the dealer's service to users*".[165] This rebate was based upon the market share which Michelin France represented of dealers' sales (the "**Service Bonus**") – i.e. the basis of the reward was linked to winning business from competitors. A progress bonus was provided as a reward for increasing the level of purchases for Michelin France products compared to the previous year (the "**Progress Bonus**"). Michelin France also entered into an agreement which applied to dealers purchasing new tyres and required them to present every truck tyre casing for re-treading (the "**PRO Agreement**").

Finally, certain larger tyre dealers were allowed into the "Michelin Friends Club", after assuming the following commitments: carrying sufficient stock to respond immediately to customer requirements (the EC found that the stock would have to match Michelin France's share of a dealer's purchases); promoting the Michelin France brand, particularly its new products; disclosing certain information concerning their sales; and not diverting "spontaneous demand" away from Michelin France tyres to other brands. Entry into the Michelin Friends Club came with a financial benefit.

## 3.2 Market definition and assessment of dominance

The relevant markets were the market for new replacement tyres and for re-treaded replacement tyres in France. Michelin France's dominant position on both was considered evident from its market shares, strong presence on adjacent markets, omnipresent commercial and technical service on the ground and leading position in the French distribution channels. Further, Michelin France's behaviour was considered to reflect the attitudes and practices typical of a company in a dominant position. The EC found its assessment confirmed the position of economic dependence that specialised dealers found themselves in, making Michelin an unavoidable trading partner.[166]

## 3.3 Legal test to establish abuse

Contrary to *BA/Virgin,* (which concerned target rebates and which could therefore be dealt with by the existing classification of object abuses set out by *Hoffmann-La Roche,* and, in particular, *Michelin I*) and *Michelin II,* addressed the issue of volume rebates.

By contrast, not only had volume rebates considered in *Michelin II* not been considered as abusive in the past, and hence did not exist as a category of loyalty enhancing rebates, but the ECJ had also previously held that *"quantity rebates systems linked solely to the volume of purchases made from the undertaking occupying a dominant position are generally considered not to have the foreclosure effect prohibited by Article [102 TFEU]*".[167] In other words, there was an existing presumption (albeit rebuttable) that quantity rebates were lawful under the dominance provisions.

[165] *Michelin II (EC)*, para. 56.

[166] *Michelin II (EC)*, para. 173.

[167] *Michelin II*, para. 58 cross-referring to *Michelin I,* para. 71 and Case C-163/99, *Portugal v Commission* EU:C:2001:189 ("***Portugal v Commission***"), para. 50.

In *Michelin II*, the object abuse framework for loyalty enhancing rebates was effectively extended by the EC and the CFI from exclusivity rebates and target rebates to include certain retroactive volume rebates. This occurred through several steps.

First, the CFI effectively narrowed the scope of pro-competitive "quantity rebates" identified in previous case law to only those quantity rebates that "*reflect gains in efficiency and economies of scale made by the [dominant firm]*".[168] It stated that quantity rebates were a proxy for passing on cost savings "*if increasing the quantity supplied results in lower costs for the supplier, the latter is entitled to pass on that reduction to customers in the form of a more favourable tariff. Quantity rebates are therefore deemed to reflect gains in efficiency and economies of scale made by the [dominant firm]*".[169]

This had the effect of narrowing the presumption of legality so that it applied only to the extent that the underlying cost presumption could be shown to be valid:

> "*a rebate system in which the rate of the discount increases according to the volume purchased will not infringe Article [102 TFEU] unless the criteria and rules for granting the rebate reveal that the system is not based on an economically justified countervailing advantage but tends, following the example of a loyalty and target rebate, to prevent customers from obtaining their supplies from competitors".*[170]

In addition, by linking the presumption of legality of quantity rebates to the narrow scope of efficiencies permitted in relation to loyalty enhancing rebates, the CFI, for the first time, created a uniform framework of analysis for all retroactive rebates. It can be seen to replace the binary "quantity / fidelity" rebate distinction from *Hoffman-La Roche*, with a new dichotomy between: (i) retroactive rebates which are deemed to reflect gains in efficiency and economies of scale made by the dominant firm and are presumed to be lawful; and (ii) those retroactive rebates that do not.

The second category included exclusivity rebates, target rebates and retroactive quantity rebates with a 'long' reference period and applied the object abuse framework, which the ECJ had developed for target rebates in *Michelin I*.[171] Specifically, in relation to quantity rebates, the CFI outlined that a familiar framework from *Michelin I* should apply "*it is necessary to consider all circumstances, particularly the criteria and rules governing the grant of the discounts and to investigate whether, in providing an advantage not based on any economic service justifying it, the quantity rebates tend to harm competition*".[172]

While this broadly replicates *Michelin I*, there are nevertheless a few changes. First, while the two limbs under the object assessment still apply (i.e. criteria and rules of the rebates and "all (other) circumstances"), there is a stronger emphasis on the former over the latter, which makes the analysis more formalistic. Second, the competitive harm of Michelin's quantity rebates was covered under three headings: (i) lack of fairness; (ii) loyalty inducing; and (iii) having a partitioning effect (which the CFI considered to flow directly from the loyalty-inducing effect). A discrimination claim was not pursued. The CFI held that any loyalty-inducing rebate system applied by a dominant firm that has

[168] *Michelin II*, para. 58.

[169] *Michelin II*, para. 58.

[170] *Michelin II*, para. 59.

[171] *Michelin II*, para. 60, quoting *Michelin I*, para. 73.

[172] *Michelin II*, para. 62.

foreclosure effects would contravene Article 102 TFEU irrespective of whether or not the rebate system was discriminatory.[173]

*Michelin II* concluded that certain retroactive quantity rebates, like exclusivity rebates and target rebates, should be assessed under an object framework and that (contrary to Article 101 TFEU) the category of an object abuse is a closed system where actual or likely effects do not have to be demonstrated.[174] No effects analysis was therefore required because, in the CFI's words, "*for the purposes of applying Article [102] EC, establishing the anti-competitive object and the anti-competitive effect are one and the same thing. If it is shown that the object pursued by the conduct of an undertaking in a dominant position is to limit competition, that conduct will also be liable to have such an effect*" (emphasis added).[175]

To support this approach, the CFI relied upon the finding in *AKZO v Commission* that "*prices below average variable costs applied by a dominant firm are regarded as abusive in themselves because the only interest which the undertaking may have in applying such prices is that of eliminating competitors*".[176] The CFI considered that this can be extended to other conduct where the *purpose* (or the "object") of the conduct is "*to strengthen a dominant position and thereby abuse it*",[177] as was the case in relation to Michelin France's rebate systems. The EC found that the purpose of the rebate systems was to tie dealers to Michelin France, and the practice restricted competition because the dealers sought to make it more difficult for competitors to enter the market.[178] The CFI then found that, given this, the actual effect of the practice was irrelevant "*the fact that the result sought is not achieved is not enough to avoid the application of Art [102]*".[179]

## 3.4 Assessment of foreclosure harm

The EC considered whether the various schemes (quantity rebates, Service Bonus, Progress Bonus, PRO Agreement and Michelin Friends Club – described more fully above) were abusive. In particular, it assessed whether these schemes amounted to unfair practices, had loyalty-inducing effects and market partitioning / foreclosing effects. As noted above, this paper focuses on loyalty-inducing effects.

### 3.4.1 Quantity Rebates

**Criteria and rules for the rebate system***.* In line with the framework established, the EC assessed the various criteria and rules for the rebate system.

While *Michelin I* and *BA/Virgin* had focused on the target nature of the rebates generating a loyalty-inducing effect (and *Hoffman-La Roche* had dealt with the exclusivity rebates), *Michelin II* looked at retroactive quantity rebates. Thus, neither the target nature of a rebate nor an exclusivity obligation were considered to be required to establish foreclosure effects. Rather, the key features of Michelin's rebate system that raised concerns about loyalty-inducing effects were the combination of: (i) the

[173] *Michelin II*, para. 65.

[174] *Michelin II*, para. 239.

[175] *Michelin II*, paras. 244, 258.

[176] *Michelin II*, para. 242 citing *AKZO v Commission*, para. 71.

[177] *Michelin II*, para. 243.

[178] *Michelin II*, para. 244

[179] *Michelin II*, para. 245.

retroactive nature of the rebates; (ii) combined with a one-year reference period; and (iii) the size of variation between the discount rates at various steps.[180]

In relation to the all-unit nature of the rebate, the CFI distinguished between "forward looking" rebates, where the discount applies only to quantities exceeding a certain threshold, from "retroactive discounts", where the discount applies to the total turnover achieved during the reference period.[181] The CFI pointed out that where a rebate is granted "by tranche", it never exceeds the percentage for the tranche in question. By contrast, where the rebate applies to the total volume purchased, an increase in turnover close to the threshold may lead to a very significant discount at the margin. The CFI therefore concluded that "*the incentive to purchase created by a quantity rebate system is therefore much greater where the discounts are calculated on total turnover achieved during a certain period than where they are calculated only tranche by tranche*".[182] Furthermore, *"[t]he longer the reference period, the more loyalty-inducing the quantity rebate system*".[183]

In relation to the 'long' reference period, which in *Michelin II* was one year, the CFI cited *Michelin I* according to which "*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 the discount or to avoid suffering the expected loss for the entire period*".[184] This was a key focus of for the EC and the remedy ultimately negotiated between Michelin France and the EC replaced the annual scale of rebates with a quarterly scale, in order to reduce the pressure on dealers to reach the next level of the scale. The CFI distinguished *British Gypsum* where a one year volume rebate had been held to be compatible with Article 102 TFEU on the basis that the rebates had been calculated from anticipated annual turnover *ex ante* rather than from actual turnover *ex post* (and that the quantity rebates in *British Gypsum* reflected actual costs savings for the dominant firm).

The CFI also considered the size of the variation between the discount rates between various steps. While the targets varied annually, they included a large number of target thresholds, varying from 18 to 54 steps. The CFI found, in line with *Michelin I*, that even where "*the variation in the rate of discount is small it may nevertheless affect the dealer's margin of profits on the whole year's sales and hence even quite slight variations might put dealers under appreciable pressure*".[185] The CFI found that where, as in this case, the variation of the rebates is significant, this should be regarded as an aggravating factor.

**All (other) circumstances.** Contrary to *Michelin I*, the EC and the CFI did not focus to the same extent as *Michelin I* (and even *BA/Virgin*) on circumstances other than the rebate system itself. In particular, the CFI held that the lack of transparency is not a necessary condition for an abusive rebate system: *"[a] loyalty-inducing rebate system is contrary to Article [102 TFEU], whether it is transparent or not*".[186]

However, the CFI did highlight the uncertainty that dealers faced due to the complexity of the overall system as an important factor in establishing the loyalty-inducing effect "*the simultaneous*

[180] *Michelin II,* paras. 75 – 78, 95.

[181] *Michelin II*, para. 85.

[182] *Michelin II*, para. 88.

[183] *Michelin II*, para. 88.

[184] *Michelin II*, para. 81.

[185] *Michelin II*, para. 91.

[186] *Michelin II*, para. 111.

*application of various discount systems…made it impossible for the dealer to calculate the exact purchase price of Michelin tyres at the time of purchase. That situation inevitably put dealers in a position of uncertainty and dependence*".[187]

**Conclusions.** The CFI concluded that "*a quantity rebate system in which there is a significant variation in the discount rates between the lower and higher steps which has a reference period of one year and in which the discount is fixed on the basis of total turnover achieved during the reference period has the characteristics of a loyalty-inducing discount system*".[188] The CFI endorsed the EC's findings that the rebates prevented dealers from being able to select freely at any time, in the light of the market situation, the most advantageous offers made by competitors and to change suppliers without suffering an appreciable economic disadvantage.

#### 3.4.2 Other rebates

**Progress Bonus / PRO Agreement.** The Progress Bonus and PRO Agreement were both essentially target bonuses: they were dependent on an increase in new tyre sales, or truck tyres, as the case may be. Such rebates were individually set and bore much more similarity to the rebates offered in *Michelin I* and *BA/Virgin*. In the case of the PRO Agreement, there were additional (standardised) amounts payable when tyres were presented for retreading. The EC considered both to be abusive and, on appeal, Michelin France did not raise any specific pleas against this finding (but only disputed it through its general argument that the EC had failed to carry out an effects analysis, which was rejected).[189]

**Service Bonus.** Michelin France argued that the Service Bonus was designed to encourage dealers to improve the quality of their services and the brand image of Michelin products. The CFI noted evidence that the bonus was fixed according to the quality of the service the dealer was able to provide, and therefore considered that there was evidence that the Service Bonus was remuneration for services rendered rather than a true rebate or discount.[190] However, the CFI found that the bonus nonetheless had a loyalty-inducing effect as, by offering a financial advantage, Michelin France sought to prevent the dealer obtaining its supplies from rival manufacturers.[191]

**Michelin Friends Club.** The EC also maintained that the Michelin Friends Club was used as a tool to rigidify and improve Michelin France's position on the market in new replacement truck tyres. Dealers who were members of the club were obliged to promote the Michelin France brand and to not divert spontaneous customer demand away from Michelin France tyres.[192] In addition, the Michelin Friends Club agreement allowed Michelin France an exceptionally far-reaching right to monitor the activities of the members, and which did not appear to be in any way justified other than by Michelin France's desire to supervise distribution in detail.[193] Any changes in the dealers' commercial or strategic policy would leave them open to reprisals on the part of Michelin France, so this was considered to have a loyalty-inducing effect.

[187] *Michelin II*, para. 111.
[188] *Michelin II*, para. 95.
[189] *Michelin II*, para 45.
[190] *Michelin II*, para 139.
[191] *Michelin II*, para. 160.
[192] *Michelin II (EC)*, para. 317.
[193] *Michelin II (EC)*, para. 322.

### 3.5 Assessment of efficiencies

As part of the efficiencies assessment, the CFI raised the question of whether "*the quantity rebate system applied by the applicant is based on a countervailing advantage which may be economically justified*".[194] As in *Michelin I* and *BA/Virgin*, the efficiencies that were "admissible" under this test were narrowly defined, such that "*[a] quantity rebate system is […] compatible with Article [102 TFEU] if the advantage conferred on dealers is 'justified by the volume of business they bring or by any economies of scale they allow the supplier to make'*"[195] (emphasis added) – i.e. the efficiencies must arise directly from the impugned rebate system. The CFI did not consider whether efficiencies can only be cost-based (i.e. because the extra volume allows certain savings) or whether it could also cover the part of any rebate which could be characterised as consideration paid to the customer to help achieve such higher volumes.

In addition, according to the CFI, it was not sufficient to show that efficiencies resulting from the rebate system were plausible; the dominant firm had to establish that the quantity rebate system, which presented the characteristics of a loyalty-inducing rebate system, was based on objective economic reasons.[196]

In this case, the CFI held that Michelin France "*merely states generally that the quantity rebates were justified by 'economies of scale in the area of production costs and distribution*'"[197] and concluded that "*such a line of argument is too general and is insufficient to provide economic reasons to explain specifically the discount rates chosen for the various steps in the rebate system in question*".[198] The CFI found that the EC was therefore entitled to conclude that the rebate system was not based on any economic justification.

### 3.6 Conclusions

*Michelin II* extended the framework that had applied initially to exclusivity rebates (in *Hoffman-La Roche*), and then to target rebates (in *Michelin I* and *BA/Virgin*), to quantity rebates. In so doing, it found, for the first time, that retroactive quantity rebates are an abuse of dominance capable of being assessed using the object framework.

Like *Michelin I* and *BA/Virgin*, neither the EC nor the CFI articulated the specific economic theory of harm in this case (nor assess the impact on end consumers) and the CFI explicitly found that an effects analysis was not needed.[199] Instead, the EC and the CFI inferred anticompetitive effects from the rebate system's "*unfairness*" (i.e. its exploitative nature vis-à-vis the tyre dealers),[200] its "*market-partitioning effect (and foreclosing effect)*"[201] and its "*tying of dealers to Michelin France*".[202] Though not specifically framed as such, in a similar vein as both *Michelin I* and *BA/Virgin*, this latter proposition suggests an exclusion theory of harm but without assessment of Michelin France's contestable and non-contestable demand (as would be demanded by a modern economic approach).

---

[194] *Michelin II*, para. 98.

[195] *Michelin II*, para.100 referring to *Portugal v Commission*, para. 58.

[196] *Michelin II*, para.107.

[197] *Michelin II*, para.108.

[198] *Michelin II*, para.109.

[199] *Michelin II* (CFI), paras 235-246.

[200] *Michelin II* (EC), para 219.

[201] *Michelin II* (EC), para 240.

[202] *Michelin II* (EC), para 227.

## C. *Post-Michelin I, Michelin II and BA/Virgin – towards an effects-based approach*

In a departure from the previous case law and in recognition of the potential pro-competitive effects of discount and rebate practices, recent years have seen a shift in focus towards an effects-based approach, as reflected by the EC's 2008 Priorities Guidance and more recently the ECJ's landmark decision in *Intel*.

### 1 EC's review of Article 102 TFEU

Following *BA/Virgin* and *Michelin II*, the EC continued to apply the by object approach to assessing rebates, including in *Solvay*[203] and *Imperial Chemical Industries*[204] (both of which were endorsed by the EU courts). In 2003 however, the EC recognised the need to review law and policy under Article 102 TFEU, launching an internal review which resulted in the publication of a Discussion Paper in December 2005. While the initial aim was to produce Article 102 TFEU guidelines similar to those that exist for Article 101 TFEU and for merger control and state aid, diverging views at the EC between the Legal Service and DG Competition led to the publication of its Priorities Guidance in 2008.[205]

The Discussion Paper and Priorities Guidance both recognised that conditional rebates were not an uncommon practice and may be offered for non-exclusionary reasons such as stimulating demand and for the benefit of customers.[206] The Priorities Guidance sets out an economic and effects-based approach to examining exclusionary conduct such as discounts and rebates based on the AEC test. It also provides detail on the types of evidence that the EC would typically look at to assess anticompetitive foreclosure. While the type of assessment more directly corresponds to the economic theory of harm of naked exclusion (i.e. exclusion through rebates with targeted offers at strategic buyers, as outlined in **Section III.B** above), it also provides a pragmatic manner for assessment of whether inducements are significant, which is of broader relevance. Although case law has confirmed the AEC test to be only "*one tool amongst others*" when determining whether a rebate is abusive under Article 102 TFEU,[207] the Priorities Guidance indicates that the EC should usually only intervene where the conduct in question would hinder competition from competitors considered to be as (or more) efficient as the dominant undertaking.[208]

### 2 Shifting between "object" and "effects" approaches

Around the time of these reforms, there was evidence of the EC and the EU courts beginning to analyse the effects of impugned rebates. For example, in *Tomra* the EC made an attempt to analyse likely effects but, as the ECJ noted on appeal, it "*merely complemented its findings of infringement with a brief examination of the likely effects*"[209] but did not base its findings on these. In *Tomra,* the EC relied on *Michelin II* and *BA/VIrgin* for the principle that it is not necessary to show actual impact on the relevant markets.[210] While the ECJ did not directly apply the AEC test as outlined in the

[203] Case T-57/01, *Solvay SA v European Commission,* para. 316.

[204] Case T-66/01, *Chemical Industries Ltd v European Commission,* para. 296.

[205] Nicholas Petit, From Formalism to Effects? The Commission's Communication on Enforcement Priorities in Applying Article 82 EC, World Competition 487 (2009).

[206] Priorities Guidance, para. 39.

[207] *Post Danmark II*, para. 61.

[208] Priorities Guidance, para. 23.

[209] *Tomra*, para. 288.

[210] *Tomra*, paras. 288-299.

Priorities Guidance (which pre-dated the EC's decision in 2006 but was in force by the time of the ECJ appeal in 2012), AG Mazak did state in his opinion that "*reference to negative and anti-competitive effects should not be mechanical. The (likely) existence of such exclusionary effects in a particular case should not be merely presumed, it should be assessed and demonstrated*".[211]

A further shift was seen in *Velux*[212]*, a* case concerning incremental rebates, which the EC found did not result in below-cost pricing and competitors were therefore not excluded from the market. This echoed the approach of the Priorities Guidance, which acknowledged that "*as long as the effective price remains consistently above the LRAIC of the dominant undertaking, this would normally allow an as efficient competitor to compete notwithstanding the rebate*".[213] The EC went on to discuss a hypothetical situation where the same rebate scheme was retroactive and concluded that it could still have been lawful, provided the company used a large number of increments.[214]

At around the same time, the ECJ moved away from the object abuse approach for cases concerning pricing abuses – evident from the 2011 decision of *TeliaSonera*[215] and the 2012 *Post Danmark I* decision, where the EU courts applied the AEC test to consider whether pricing was predatory. However, the AEC test approach was not wholly extended to rebates, as seen in the ECJ's 2015 decision in *Post Danmark II.* In *Post Danmark II,* which considered target rebates, the ECJ found that there was no legal obligation to apply the AEC test to determine if a rebate scheme is abusive, but that it must be considered as merely one tool among others for examining the compatibility of rebates with Article 102 TFEU.[216] It did so, however, in a very specific context of a former state monopoly with extremely significant scale and scope externalities. The ECJ emphasised a more effects-based analysis, in particular the need to consider "all circumstances" around granting of a rebate, including the extent of dominant position and competitive conditions prevailing in the market.

## 3 The *Intel* decision

The move towards an effects-based approach to assessment of rebates was confirmed in the ECJ's ruling in *Intel* in 2017, which focussed primarily on exclusivity rebates but had clear application to target rebates also. The ECJ rejected the General Court's ("**GC's**") view that, because fidelity rebates are always capable of restricting competition "*by their very nature*", it is unnecessary to consider whether the individual circumstances of the case involve a foreclosure effect.[217] In so doing however, rather than rejecting or replacing the object framework developed in *Hoffman-La Roche* and the Focus Cases outright, *Intel* created two "exit routes" from an object to an effects analysis: (i) establishing that the conduct is not capable of restricting competition; and (ii) showing that the anticompetitive harm is outweighed by efficiencies.

As a starting point, the ECJ clarified that the presumption that fidelity rebates infringe Article 102 TFEU developed in *Hoffman-La Roche* and subsequent cases is rebuttable, the same as any other presumption under EU competition law.[218] While the evidential burden is initially on the dominant undertaking to show that its rebates are not capable of restricting competition if it submits plausible

---

[211] Opinion of AG Mazak in Case C-549/10 P, *Tomra Systems ASA v Commission*, paras. 43-44.

[212] Case COMP/39.451, *Velux* (2009) (not published); *See* Bill Batchelor and Kayvan Hazemi Jebelli, Rebates in a state of Velux: filling in the gaps in the article 102 enforcement priorities, ECLR 2011.

[213] Priorities Guidance, para. 43.

[214] Svend Albaek and Adina Claici, The Velux case: an in-depth look at rebates and more, Competition Policy.

[215] Case C-52/09, *TeliaSonera Sverige*, paras. 40-46.

[216] *Post Danmark II*, paras. 57-58.

[217] Case T-286/09, *Intel v Commission*, paras. 77, 81, 85 and 87; *Intel*, paras. 141 and 144.

[218] *Intel*, para. 137.

evidence to that effect, the burden then shifts to the EC to demonstrate that the rebates are capable of foreclosing as efficient competitors (i.e. to carry out an effects-based analysis).[219] In line with the framework of abuse restrictions under Article 101(1) object restrictions, the ECJ offered two ways of how to rebut the presumption of harm, namely: (i) showing lack of capability of harm; and (ii) establishing an efficiency defence.[220]

**Lack of capability of harm**. The first exit route out of the previously closed object abuse box established by *Hoffman La Roche* is "*evidence that [the dominant firm] was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects*".[221] This required a clear understanding of what amounts to anti-competitive foreclosure. In line with the *Post Danmark ca*ses, the Court seems to opt for the AEC standard, i.e. "*the intrinsic capability… to foreclose competitors that are at least as efficient as the dominant undertaking*".[222] By contrast, the departure of less attractive rivals is an inherent feature of competitive process and is therefore unproblematic.[223]

The ECJ was not entirely clear about the type of evidence that the dominant firm has to put forward regarding lack of capability to move the case to an effects analysis. As is the case in relation to Article 101(1), plausibility seems to be an appropriate standard.

**Efficiency defence**. the ECJ also noted that a system of rebates may be objectively justified and that "*advantages in terms of efficiency which also benefit the consumer*" may counterbalance or outweigh anticompetitive foreclosure effects.[224] Such an analysis balancing the effects should be carried out only after considering the intrinsic capacity to foreclose as efficient competitors.[225] Thus, the ECJ provides a second exit door which could lead out of the object abuse box, namely the efficiency defence. Under Article 101 TFEU, the efficiency defence is explicit on the face of the statute and its requirements are clearly set out under Article 101(3) TFEU. In *Intel,* in a similar way, the ECJ states that exclusionary effects can be counterbalanced by efficiencies (i.e. a balancing exercise – only capable under an effects-based analysis which allows quantification of the relative harms and efficiencies, is required).[226] While the ECJ is silent as to what a dominant firm must establish to open the efficiency exit door out of the object abuse box, it would appear reasonable to apply a plausibility standard in line with *Budapest Bank* and the lack of capability defence above.

The ECJ did not address the novel threefold categorisation of rebates which had been proposed by the GC,[227] leaving the categorisation of rebates somewhat of a grey area under EU competition law. Neither did it consider the need to scrutinise "all circumstances" of the rebates as argued by the appellant and *AG Wahl*. The switch to an effects-based analysis via a plausible "lack of capability" provided an alternative solution.

[219] *Intel*, para. 139.

[220] *Intel*, para. 140.

[221] *Intel*, para. 138

[222] *Intel*, para. 140.

[223] Colomo, "the Future of Article 102 after *Intel", Journal of European Competition Law and Practice* 9(5), 298 (2018).

[224] *Intel*, para. 140.

[225] *Intel*, para. 140.

[226] *Intel*, para. 140.

[227] In Case T-286/09 *Intel v Commission* ECLI:EU:T:2014:547, paras. 74-78, the GC identified three categories of rebates to which distinct legal rules apply: (i) quantity rebates, (ii) fidelity rebates and (iii) other types of rebates which do not fall neatly within either category. AG Wahl rejected this approach in his Opinion in the subsequent appeal to the ECJ, referring to quantity rebates and fidelity rebates as the only two types of rebates recognised by the case law (Case C-413/14 P, *Opinion of AG Wahl*, ECLI:EU:C:2016:788 ("***AG Wahl***"), para. 81). Whilst the ECJ set aside the GC's judgment, it did not comment on its threefold categorisation of rebates, leaving this somewhat of a grey area under EU law.

The real impact of *Intel* was that it caused the debate to shift from considering whether an effects test is required to consider how anticompetitive effects may be demonstrated. It is clear that the level of analysis required to establish anticompetitive effect has increased substantially since the (fairly low) standard applied in the Focus Cases. Consequently, the ECJ imposed a procedural obligation on the EC to consider any evidence produced by the defendant tending to show a lack of anticompetitive foreclosure effects. Although this applies as a rebuttable presumption for exclusivity rebates, it follows that the same is necessary for other forms of rebate. However, it is yet to be seen how complete or precise the EU courts will require the EC's assessment of foreclosure effects to be, and this will likely be a key question for future cases.

While the ECJ has formally confirmed the existence of a presumption (at least for exclusivity clauses), it has also clearly stated wide possibilities for its rebuttal. One can expect that prosecuted companies will systematically attempt to rebut this presumption, on the grounds that the non-linear prices correspond to plausible procompetitive rationales and/or that that their conduct is not capable of restricting competition to the detriment of consumers. In this case, a debate on the likely effect of the behaviour will inevitably take place. In this context, one can question the relevance of the presumption in the first place.

# V. EVALUATION OF APPROACH TAKEN IN THE FOCUS CASES

In this Section, we seek to evaluate the approach taken by the EC and EU courts in the Focus Cases in light of modern legal and economic thinking. In so doing, we are conscious of the risk that reviewing these cases with the benefit of hindsight, a refined legal framework and an understanding of further progress in economic theory may lead to an unfair assessment (and to somewhat smug conclusions). We have tried not to fall into this trap and instead focussed on how the frameworks used in the Focus Cases could inform the modern debate.

This **Section V** is divided into two parts. First, **Section V.A** evaluates the analytical framework created by the Focus Cases for conditional rebates. In particular, we contrast this framework with the modern frameworks, under both Article 102 TFEU and in light of the development in the approach to the object / effects distinction in the context of Article 101 TFEU. Second, **Section V.B** evaluates the results of the Focus Cases in light of the facts, applying a revised, up to date analytical framework. In this section, we look in particular at whether the facts as presented in the Focus Cases justify the conclusions reached at the time.

## A. Evaluation of the analytical framework created by the Focus Cases

### 1 Building an object abuse framework for conditional rebates

As described in **Section IV**, the Focus Cases built a comprehensive object abuse framework for conditional rebates. *Michelin I* established the two-stage framework, followed – at least nominally – in all three Focus Cases. At the first stage, the authority considers whether the discount is of a kind that can be expected to (or "tends to") have a harmful impact on competition, taking into account: (i) the rules and criteria for grant of the rebate; and (ii) all other circumstances. At the second stage of the analysis considers whether the rebate provides an advantage based on any economic service which would justify it.

#### 1.1 Definition of categories of object abuses

The starting point for the Focus Cases was *Suiker Unie* and *Hoffmann-La Roche,* which had outlined a binary classification for rebates. On the one hand, "exclusivity rebates", being rebates payable on the condition of obtaining "*supplies exclusively from a particular undertaking… [including] the granting of fidelity rebates intended to give the purchaser an incentive to obtain his supplies exclusively from the undertaking in a dominant position*".[228] On the other hand, "quantity rebates" which are *"exclusively linked with the volume of purchases from the producer concerned".*[229]

The classification created by *Suiker Unie* and *Hoffmann-La Roche* raised a number of conceptual problems which became increasingly visible through the Focus Cases. First, the two original categories of rebates defined in *Hoffmann-La Roche* (exclusivity rebates and quantity rebates) are not exhaustive: the Focus Cases saw the "object" category expanded to include target rebates and, in *Michelin II*, rebates that were in the form of pure quantity rebates, but were nonetheless impugned as abusive as outlined above. The binary classification forced the EC and EU courts to continually expand the "fidelity rebates" category as failure to classify a rebate, as such would result in a finding of no infringement. Second and closely related to this, the categories identified by *Hoffmann-La Roche* and the Focus Cases are not in reality strict or mutually exclusive: (i) standardised rebates linked to exclusive or near-exclusive dealing may be *de facto* exclusive (although that is unlikely, as

[228] *Hoffmann-La Roche*, para. 90.

[229] *Hoffmann-La Roche*, para. 90.

they are standardised); (ii) target rebates may also be *de facto* exclusive; and (iii) retroactive quantity rebates may become *de facto* close to target rebates if you have multiple thresholds. Moreover, as explained in **Section III.B**, economic theory does not suggest a distinction can be made on the basis of the form of a rebate alone.

*Michelin I* highlighted the first issue, namely that the categories of loyalty rebates are not exhaustive – despite the EC's best efforts to label target rebates as falling within the category of "exclusivity rebates" within the meaning of *Hoffmann-La Roche,* and Michelin NV's attempts to characterise the rebates as "quantity rebates" – it was clear, and indeed the ECJ concluded, that the rebates in *Michelin I* were neither exclusivity nor quantity rebates and belonged in a separate category (which the ECJ called "target rebates").

As a result, the ECJ had to build an entirely new framework for this new category of rebates. It extended the object abuse framework to "target rebates" defined as those "*characterised by the use of sales targets*", which differ from a *"mere quantity discount linked solely to the volume of goods purchased since the progressive scale of the previous year's turnover indicates only the limits within which the system applies*".[230] Thus, the individualised nature of the targets was an important factor.

The categorisation issue arose again in *Michelin II*, where, this time, the potential abuse concerned quantity rebates which were not individualised but set on a "standard" basis across dealers (albeit with many levels). Again, the CFI had to consider afresh how to deal with yet another category, extending the object abuse consideration from target rebates and defining a new set of "loyalty rebates" (retroactive rebates with a reference period of one year or more).

The second conceptual issue, namely that the categories are in reality neither strict nor mutually exclusive, was highlighted in *Michelin II.* Here, the binary distinction between exclusivity and target rebates (presumptively harmful) and quantity rebates (presumptively benign) were not found to reflect the versatile nature and impact of rebates. The CFI addressed that issue by further widening the concept of a by object abuse to also include certain quantity rebates. Indeed, *Michelin II* can be read to extend the object abuse framework to all rebates except rebates *"justified by 'economies of scale in the area of production costs and distribution".*[231]

## 2 The consideration regarding competitive harm

As outlined in **Section III.C.2** above, the object / effect dichotomy under Article 101 TFEU is grounded in the consensus that certain types of arrangement can be regarded "*by their very nature as being harmful to the proper functioning of normal competition since they normally produce inefficient outcomes and reduce consumer welfare*".[232] In other words, there are certain arrangements where an informed assumption can be made that it will harm competition.

This approach is perhaps most explicitly applied in an Article 102 TFEU context by the ECJ in *AKZO v Commission*, which found that "*a dominant undertaking has no interest in applying such prices [below average variable costs] except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss*".[233] On this basis, the ECJ is confident in making the assumption that such pricing practices harm competition.

[230] *Michelin I*, para 72.

[231] *Michelin II*, para. 108.

[232] *AG Bobek Budapest Bank Opinion.*

[233] *AKZO v Commission*, para 72.

### 2.1 Framework for target rebates

In *Michelin I,* the ECJ took the view that individualised rebates: (i) with a reference threshold relative to previous year's volume; (ii) which are retroactive; (iii) where the dominant player has a market share which is significantly larger than the shares of its competitors; and (iv) where there is a lack of transparency over the rebate system, inherently have a negative effect. The ECJ concluded that the combination of these factors put dealers under "considerable pressure" to obtain the sales targets, and that competitors could not meet the offer because they would need to make up the absolute value of Michelin NV's rebate over a much smaller volume of sales.

**Lack of benchmark.** *Michelin I* and indeed all Focus Cases suffer from the fact that, contrary to *AKZO*, or indeed *Intel*, they draw no clear division between pro-competitive pricing (which happens to lead to the exit of certain competitors) and anti-competitive foreclosure pricing strategies.

- The Priorities Guidance outlines the AEC Test, which requires the EC to investigate whether the rebate system in question "*is capable of hindering expansion or entry even by competitors that are equally efficient*".[234] In *Post Danmark II,* the ECJ did not consider the test binding but noted that it was one tool among others for examining the compatibility of rebates with Article 102 TFEU.[235] It took a similar view in *Intel* but appeared to effectively endorse the AEC test by noting that the EC is required to focus on "*the intrinsic capability… to foreclose competitors that are at least as efficient as the dominant undertaking*".[236]
- While the ECJ's conclusion that it would be difficult for competing suppliers to meet Michelin NV's offer over a smaller volume of sales does bear some similarity to the AEC test, it is not clear whether the EC and the ECJ are concerned in this assessment with the protection of all competitors or only of equally efficient firms.
- As a result, there is (and indeed there can be) no evidence that the conditional rebates offered by Michelin and BA were harmful. This means the presumption that certain categories of rebates "tend to be harmful" cannot be properly tested.

**Questionable assumptions.** In addition to the lack of a clear benchmark, the *Michelin I* analytical framework is based on a number of assumptions which may or may not be true. First, the impact of a growth-based target will depend to a large extent on whether the market is static, growing or declining. Nor does the framework take into account the possibility that the pricing system itself may expand demand (e.g. through efficient price discrimination leading to an overall increase in output, as explained in **Section III.B** above).

Second, the retroactive mechanism coupled with Michelin NV's high market share would not necessarily foreclose access to most or even many customers, if customers buy predominantly or exclusively from one supplier (e.g. a 50% market share may be the result of the dominant firm satisfying the entire demand of customers whose volumes represent 50% of the market, which in turn could – and indeed is likely to – represent less than 50% of customers). Depending on those circumstances, the effect of a target rebate may be very different, but neither the EC nor the ECJ evaluate (or appear to consider the evidence that would be required to evaluate) whether the implicit assumptions hold true.

In addition, the size of the rebate did not play any significant role, despite the fact that it is clearly a critical element in determining the foreclosure effect of any rebate. Without consideration of these

[234] Priorities Guidance, para. 41.

[235] *Post Danmark II*, paras. 57-58.

[236] *Intel*, para. 140.

factors, it is difficult to clearly identify a threshold level at which a pro-competitive price reduction becomes an anticompetitive foreclosure strategy.

### 2.2 Framework for retroactive quantity rebates

*Michelin II* extends the presumption of harm from individualised retroactive growth rebates to all target rebates with a one-year reference period, where there is a significant variation in discount rates between the different steps of the rebate scheme. The deficiencies of the *Michelin I* framework (i.e. lack of clear benchmark of what constitutes anticompetitive foreclosure and assumptions which do not hold universally) are equally relevant here.

In addition, the presumptions of competitive harm appear even more tenuous. First, the key basis of presumed harm, for retroactive quantity rebates, seems to be that close to the trigger threshold, the effect of a retroactive rebate is likely to be “predatory”, and competitors will not be able to compete for those volumes. However, in most circumstances, competitors will not be restricted to compete for volumes at or near the target threshold. No thought seems to be given to what the competitive advantage of the dominant firm is, what volumes competitors are able to compete for (i.e. the share of demand that is contestable) or whether the rebate scheme in question makes it difficult or impossible for rivals to compete.

Second, the read across from individualised rebates in *Michelin I* and *BA/Virgin* to generalised rebates in *Michelin II* is questionable. A first principles approach would suggest that individualised rebates are more likely to harm competition, as outlined above. In principle, therefore, any anticompetitive effect of such a system is “blunted” because of the inability to target individual purchasers’ volume requirements.[237] Indeed, in both *Michelin I* and *BA/Virgin*, the individualised nature of the growth-targets was considered a critical factor in generating the loyalty effect. Arguably, the number of “standardised” rebate thresholds in *Michelin II* could be considered to have generated a similar effect to an individualised target, on the basis that, at any given point, a “target” was available that would closely correspond to a buyer’s total demand. However, such theory of harm is not made explicit by either the EC or the CFI.

In addition, the Court’s claim in *Michelin II,* that even rebates of a small size are presumptively harmful while at the same time being very focused on the length of the reference period is surprising given that rebates of a smaller size with longer a reference period can be expected to have comparable effects on competition to rebates of a larger size with a smaller reference period. Along similar lines, it appears inconsistent that the large size of a rebate is an aggravating factor while the smaller size of a rebate is not a mitigating factor.

Finally, given that the presumption on competitive harm rests on relatively weak foundations, one would have expected the Court to put less emphasis on the characteristics of the rebate and more emphasis on all (other) circumstances, in particular the market characteristics. The opposite has occurred: in *Michelin II*, the focus of the analysis is clearly on characteristics of rebates rather than exploration of all (other) circumstances, and hence the analysis is even more form-driven. On such a form-driven approach, it can be observed that, taking the Focus Cases together, three of the four categories of rebates we outlined in **Section III.A** are considered to give rise to presumptions of illegality, at least where certain conditions are met. The only categories of rebates which are not impugned are incremental rebates and retroactive quantity rebates with a short duration. This establishes a position that is not coherent with the prevailing economic view that rebates can be pro or anticompetitive, depending on the circumstances.

---

[237] O’Donoghue and Padilla, page 1228.

**The use of a new presumption**. Prior to *Michelin II,* the "problematic", loyalty-inducing rebate systems had been defined by their contrast to quantity rebates [238] *Michelin II* effectively reversed this presumption that quantity rebates were permissible. The CFI instead noted the need to consider all circumstances, including whether the rebates were used "*to strengthen a dominant position and thereby abuse it*".[239]

When identifying whether a category of conduct should fall into the object box under Article 101 TFEU, AG Bobek in his *Budapest Bank* opinion noted that the key question is whether its "*harmful nature is in light of experience commonly accepted*" and that there needs to be "*robust and reliable experience about the nature of the agreement*".[240] It follows that novel categories of object abuses should not be created without consensus about the effect on competition (even if such consensus can change over time in light of new evidence).

The approach in *Michelin II* was vastly different. No evidence was adduced to show that retroactive quantity rebates tend to be harmful. Nor did the Court consider whether such rebates were used by non-dominant firms. The CFI noted the EC's approval of a quantity rebate scheme in *British Gypsum,* but highlighted specific differences in the form of the rebate schemes.[241] It appears to therefore reinterpret its presumption as applying to only a narrow sub-set of quantity rebates.

For completeness however, we note that the approach adopted in *Michelin II* has not been widely accepted as creating a presumption that retroactive quantity rebates are abusive. The Discussion Paper noted that when the "*threshold set in a standardised volume threshold, it is less likely that the rebate system will have a loyalty enhancing effect*".[242] This position has been reiterated by the ECJ in *Post Danmark II*[243] and *Intel.*[244]

## 3 The considerations regarding efficiencies

As discussed in **Section III.B.1**, there is consensus among economists that rebates can have a number of pro-competitive justifications.[245] The fact that a rebate is offered by a dominant entity does not preclude these pro-competitive effects. The EC and the EU courts seem to acknowledge this, and state in all three Focus Cases that efficiencies are considered. In practice however, the analysis is very limited. The efficiency justifications put forward in *Michelin I* (largely disputing the characterisation of the rebate system) were not seriously considered. More detailed justifications were put forth in *Michelin II* and *BA/Virgin*, but the EC and EU courts dealt with the justifications put forward in a relatively perfunctory manner.

[238] *British Gypsum*, para. 69.

[239] *Michelin II,* para. 62.

[240] *AG Bobek Budapest Bank Opinion*, para. 63; cited by the ECJ in C-228/18, *Gazdasági Versenyhivatal v Budapest Bank Nyrt* EU:C:2020:265, para. 76.

[241] *Michelin II,* para. 84.

[242] Discussion Paper, para. 159.

[243] *Post Danmark II,* para. 27: "*It is also settled case-law that, in contrast to a quantity discount linked solely to the volume of purchases from the manufacturer concerned, which is not, in principle, liable to infringe Article 82 EC, a loyalty rebate, which by offering customers financial advantages tends to prevent them from obtaining all or most of their requirements from competing manufacturers, amounts to an abuse within the meaning of that provision*."

[244] *Intel,* para. 75 accepted that quantity rebates "*are generally considered not to have the foreclosure effects prohibited by Article [102] TFEU*".

[245] These include enhancing efficiency through better covering fixed costs (i.e. economies of scale), alignment of incentives between the supplier and customer (particularly where the supplier has made a relationship-specific investment in the customer) and reducing double marginalisation.

This is primarily because, in all three Focus Cases, the EC and EU courts narrowly defined the kinds of efficiencies that were "admissible", such that efficiencies could only be considered to the extent that the rebate provided an advantage based on any economic service justifying it. In *Michelin II,* for example*,* the EC held that "*a rebate can only correspond to the economies of scale achieved by a firm as a result of the additional purchases which customers are induced to make*" (emphasis added).[246] Similarly, in *BA/Virgin*, the EC argued that a dominant supplier can give discounts that relate to efficiencies (e.g. on a large order), but should not give discounts or incentives to encourage loyalty, suggesting that rebates could be either loyalty-based or efficiency-based, with no interaction between the two.[247]

The Focus Cases therefore seem to contemplate only efficiencies arising out of direct economies of scale in production and distribution. None of the Focus Cases justify this narrow framing of permissible efficiencies nor explain why other kinds of efficiencies could not be relevant to the analysis.

This narrow definition of rebates means there is no real scope to explore the extent to which a rebate system could represent competition on the merits and when it crosses the line into being abusive. The ECJ in *Michelin I* opines that rebates are problematic when used by a dominant firm that has "*recourse to methods different from those governing normal competition*".[248] However, neither the EC nor the ECJ explore whether target rebates are frequently used by non-dominant firms. While this would not necessarily provide a conclusive picture regarding abusiveness, it would be a relevant consideration as to whether efficiencies are prevalent. This issue is even more acute on the facts of *Michelin II,* given the standardised nature of the rebates, but it is not explored.

Even if one were to accept the narrow interpretation taken in *Michelin II* and *BA/Virgin*, the requirements to meet this efficiency standard remain unclear in practice. It is well established that quantity rebates may expand volumes and increase economic efficiency by allowing large customers to purchase goods closer to their marginal cost of production,[249] but the EC's insistence that each and every penny of price reduction needs to be causally linked to costs savings of each and every unit is impractical and disproportionate. No company does such accounting and there are a number of difficulties with forming a methodology to measure costs in an industry, deciding how cost savings can be attributed to each customer and laying down the appropriate time period for recovery of fixed costs.[250] The Focus Cases also fail to account for the fact that economies of scale are rarely linear.

More importantly, the framework established by the Focus Cases is ill-adapted to grapple with the complexities of the real world. Rather than a dichotomy between efficiency ties and loyalty ties, most commercial practices take place somewhere between the two extremes. The mere fact that a rebate is designed to acquire / retain clients does not necessarily imply an adverse effect on competition and can in fact have a pro-competitive effect and vice versa.[251] Retroactive rebates are a common business practice and could make economic sense even in the absence of any exclusionary motive.

[246] *Michelin II (EC)*, para. 216.

[247] *BA/Virgin (EC)*, para. 101.

[248] *Michelin I*, para. 70.

[249] Giuilio Federico, *When rebates are exclusionary* (2005).

[250] Denis Waelbroeck, Michelin II: A per se rule against rebates by dominant companies? Journal of Competition Law and Economics, page 158 (2005).

[251] Denis Waelbroeck, *Michelin II: A per se rule against rebates by dominant companies?* Journal of Competition Law and Economics, page 156 (2005).

In some cases, it may simply be cost efficient overall for firms in high fixed cost industries to make an extra effort to retain the marginal slice of a firm's demand.[252]

## 4 Interaction between object and effects analysis

**Open vs. closed systems.** Under Article 101 TFEU, there is a permeable border between object and effects restrictions: failure to meet the object standard means that authorities are required to apply an effects analysis. This has allowed the EU courts to set a relatively high threshold for object restrictions, namely that the restriction in question cannot be shown to have any plausible efficiencies (i.e. the application of a "but for" standard or, on an alternative reading, an "expected harm" standard).

By contrast, the Focus Cases have created a hermetically closed object abuse framework for conditional rebates. Failure to establish an object infringement leads to the conclusion that no abuse has been committed at all. There is no path between the object and effects frameworks. This way of thinking has its genesis in the early precedent from *Suiker Unie* and *Hoffman-La Roche*, based on the binary distinction between illegal "loyalty rebates" and permissible "quantity rebates". Despite each Focus Case considering a new kind of rebate, the approach remained focussed on placing the rebate scheme in the illegal or permissible "box".

**Risk of overinclusion.** The closed nature of the abuse framework devised by the Focus Cases has a number of significant drawbacks. The binary outcome (finding of an object abuse or of no abuse) gives competition authorities a very stark choice between over-enforcement and under-enforcement, when, in many cases, the right answer would be to apply a detailed effects analysis. Furthermore, the stark consequence for failing to establish an object infringement creates a temptation to lower the bar for an object abuse and cast the net widely. This is precisely what we saw with the Focus Cases: rather than applying the strict "but for" standard, the Focus Cases have defined efficiencies narrowly and required that the dominant firm show that efficiencies are not only plausible but that they can be established under the requisite standard of proof. While it is not possible to evaluate with hindsight whether a full evaluation of efficiencies would have changed the outcome of any of the Focus Cases, as we have shown above, such an approach makes over-enforcement inevitable.

**Inconsistency between Articles 101 and Article 102 TFEU.** In addition, the approach in the Focus Cases creates a situation in which both the scope of the harm considered and the treatment of efficiencies is inconsistent between Articles 101 and 102 TFEU. The framework under Article 101 TFEU which allows an "exit" from an object-based analysis at an early stage allows a much fuller assessment of both the scope of the harm and the range of efficiencies to be considered. This reinforces the closed nature of the object category under the Focus Cases framework.

**Dynamic vs. static.** Finally, the open system under Article 101 TFEU has the advantage of being dynamic (i.e. it adapts to changing market conditions and is able to incorporate a better understanding about the underlying drivers of contested measures). This applies to both the assessment of harm and efficiencies. Only practices which are well understood and known to be harmful are suitable for the assessment under the object framework. AG Bobek in *Budapest Bank* emphasises that "*robust and reliable experience about the nature of the agreement*" is required to ground an object analysis.[253] At the same time, efficiency rationales for certain practices are better

[252] *See* Brian Sher, *Price discounts and Michelin 2: what goes around comes around* (2002).

[253] *AG Bobek Budapest Bank Opinion*, para. 63.

understood. It will be easier for defendants to meet the plausibility standard and to ensure that infringements are considered under the effects framework.

By contrast, the closed abuse framework of the Focus Cases has struggled to adapt to changing circumstances. The extension of the abuse framework to an ever wider range of conditional rebates has occurred without consideration of whether experience has demonstrated that those rebates are overwhelmingly harmful. This was particularly the case for retroactive quantity rebates in *Michelin II*. At the same time, given the rigid definition of “acceptable efficiencies” and the high evidential bar for dominant firms to demonstrate such efficiencies, the system did not consider efficiencies in detail and was not able to ‘learn’ from the increased understanding of efficiency drivers of rebates.

## 5 Balancing of harm and efficiencies

In its assessment, competition law foresees a balancing of competitive harm and efficiencies either explicitly (as is the case under Article 101 TFEU) or implicitly (e.g. EU Merger Regulation or Article 102 TFEU). In practice, these balancing exercises have turned out to be challenging, partly because it is difficult to quantify competitive harm and efficiencies in a comparable way and partly because litigation strategies will incentivise authorities to minimise harm or efficiencies depending on whether a case is heading towards an infringement finding or to no action.

Of the three Focus Cases, *BA/Virgin* is the only case that deals explicitly with this aspect of the competition analysis. It raises two potential problems. The case demonstrates that the object abuse framework is inherently incapable of balancing harm and efficiencies. This is because even if efficiencies can be proven and quantified, no balancing is possible when the competitive harm is analysed under an object framework (i.e. it is only established that a particular rebate *tends* to harm consumers, and such harm is not quantified). Indeed the abuse framework does not foresee a balancing at all: the moment an acceptable efficiency is identified, the presumption of harm is overturned and hence there is no finding of abuse. This is clearly unsatisfactory from a policy perspective, as even a very small acceptable efficiency would overturn a very large (presumed) harm. In response to this, the EC and EU courts have addressed this conundrum by drastically reducing the scope of “admissible” efficiencies to such an extent that they are not relevant.

Flowing from this, the approach creates different standards of proof for harm and efficiencies, with harm effectively presumed, but the scope of efficiencies that can be considered severely curtailed to the extent that efficiencies which would be taken into account under an effects-based approach are not even considered.

## 6 The cases and policy developments post *Michelin II*

The policy developments (introduction of the Priorities Guidance) and more recent cases (*Post Danmark I, Post Danmark II* and *Intel*) have addressed some of the major deficiencies of the Focus Case framework.

The ECJ’s clarification in *Intel* that, while the presumption that fidelity rebates infringe Article 102 TFEU stands, it is rebuttable, provides the previously missing bridge between an object and effects analysis of conditional rebates. As outlined above, *Intel* provides two possible “exits” from an object-based analysis. First, if the dominant undertaking submits evidence that the rebate scheme is not capable of restricting competition, in which case the burden shifts to the EC to demonstrate that the rebates are capable of foreclosing competitors (i.e. to carry out an effects analysis).[254] Second, the

[254] *Intel*, para. 139.

submission of plausible evidence of efficiencies that outweigh the putative harm to competition can also lead to an effects-based analysis.

This also brings a greater level of harmony with the approach under Article 101 TFEU, as it lines up with the logic of the double test presented by AG Bobek in *Budapest Bank*.

In addition, the Priorities Guidance provides a detailed framework for an effects analysis of conditional rebates, as further explained below.

## B. Evaluation of the analysis of the Focus Cases in light of the facts

### 1 An effects-based analysis is appropriate for the Focus Cases

Under the modern framework for assessment of fidelity rebates under Article 102 TFEU, as set out by the ECJ in *Intel*, even if the rebate schemes in question were appropriately classified as sitting within the "object" box initially, the presumption of harm is rebuttable and evidence put forward by the investigated parties that its rebates are not capable of restricting competition would shift the burden to the EC to establish that the rebate scheme had an anticompetitive effect. As set out in **Section V.A** above, the authors consider that there is insufficient evidence or experience to ground an assumption of harm in the first instance, especially in relation to *Michelin II*, and thus consider that an effects analysis should have been adopted from the outset. At a minimum however, and even if an object-based approach was appropriate in the first instance, we consider that there were potentially plausible efficiency justifications for the conduct in the Focus Cases, that would have justified a shift from an object-based to an effects-based approach.

While it is always difficult to assess ex-post the quality of the procompetitive rationales brought forward by the parties, there are a number of plausible explanations in the Focus Cases that are not addressed at all.

In *Michelin I*, Michelin NV argued that the rebates would lead to increased sales. Michelin NV also argued that the rebates enabled it to better plan its production and that this was necessary due to a lack of official statistics in the relevant period. While the classification of both these arguments as efficiency justifications is questionable, the first at least conceivably corresponds with procompetitive price discrimination that increases overall output as described in **Section III.B**. However, both justifications were dismissed by the EC and the ECJ and the decisions do not provide sufficient detail to allow the authors to form a view on their plausibility.

In *BA/Virgin*, BA argued that its rebate system represented competition on the merits. The EC and the EU courts ignored that rewarding the agents on the basis of absolute sales (as opposed to based on the targets set) would have only rewarded larger agents (even if their incremental sales were quite small). Under standard principal / agent theory, the BA scheme could very well be a reasonable way of providing incentives / rewards to their dealers. This justification, in the authors' view, at least, meets AG Bobek's standard of plausibility, such that it merits a fuller consideration.

Finally, in *Michelin II*, there is some evidence that manufacturers in the tyre sector were becoming more directly concerned with distribution of tyres and intended to solve these issues through the development of integrated networks and closer contacts with independent dealers. Arguably, Michelin France's rebate scheme was a means to align dealers' incentives with its sales expectations. Moreover, there was evidence that independent tyre dealers in France were operating on very thin profit margins due to strong downstream competition, and the direct invoice discounts were typically passed on to customers, meaning that the deferred discount paid though rebates was often a (if not the most) significant part of dealers' profits. These factors might, or might not, justify some of the precise features of Michelin's price system. Similarly to *BA/Virgin*, the authors consider this justification was at least sufficiently plausible to merit further consideration.

In each of the Focus Cases, only a full and thorough assessment of possible procompetitive justifications would have allowed an answer to the question of whether a procompetitive justification existed, and, in turn, whether the procompetitive effects of the rebate outweighed any anticompetitive effects.

## 2 An effects-based analysis would consider the following aspects

The Focus Cases were thin on evidence-based analysis of anticompetitive foreclosure effects, largely as a result of the view that establishing anticompetitive object and effect is the same.[255] An effects analysis would have required substantial additional information, which on the face of the decisions, did not appear to be in evidence in the Focus Cases.

First, and perhaps most critically, as recognised in the Priorities Guidance, the likelihood of foreclosure is greater when the dominant firm has an assured share of demand (i.e. there is a "non-contestable" portion of demand), which provides the dominant company with the ability (if not the necessarily incentive) to leverage this share of the demand to increase its share of supply further. None of the Focus Cases involved an analysis of the contestable versus non-contestable demand in the market. Such information would have allowed the EC to assess the extent to which the rebate systems were capable of hindering expansion or entry by equally efficient competitors.

More generally, the Priorities Guidance lists a number of factors that are relevant to the assessment of anticompetitive foreclosure in Article 102 TFEU cases: (i) degree of dominance; (ii) market conditions (entry and expansion, economies of scale etc.); (iii) strength of competing undertakings; (iv) strength of customers and/or input suppliers; (v) extent of the anticompetitive conduct in question; (vi) possible evidence of actual foreclosure; and (vii) internal evidence of any exclusionary strategy.[256] The Focus Cases did not consider these types of evidence in detail and it is not apparent from the decisions that such evidence was even on file.

To take *Michelin I* as an example, while we cannot rule out that Michelin NV's rebate scheme generated harm, the facts provided in the decision do not allow us to independently assess the likelihood of harm or how the scheme would impede effective competition. The case file (at least as evidenced in the decisions) leaves several open questions. For instance, what is preventing competitors from growing and making counter offers; is there an issue of miscoordination of buyers? Such evidence would have allowed evaluation of whether foreclosure required "large" price reductions that compensate dealers for anticompetitive loyalty (which could be assessed with the as efficient competitor principles presented in the Priorities Guidance), and if not, what mechanism would allow foreclosure. Finally, it would have been crucial to fully explore whether there was any reason to believe that restricting dealers' freedom corresponds to plausible procompetitive rationale.

An effects-based approach would seek and evaluate evidence on each of these questions in order to assess and balance pro and anticompetitive effects of the rebate scheme.

[255] *See Michelin II*, para. 241.

[256] Priorities Guidance, para. 20.

## VI. CONCLUSION

The Focus Cases created an analytical framework for conditional rebates which can best be described as a ‘hermetically closed object abuse’ framework. Exclusionary rebates, target rebates and ultimately certain retroactive quantity rebates were all seen as categories of rebates which can be expected to (or ‘tend to’) have harmful impact on competition. While *Michelin I* imposed an obligation on the authority to take into consideration “all circumstances”, including the specific market conditions, this aspect of the framework subsequently lost importance which resulted in an increasingly formalistic analysis. While the framework of the Focus Cases foresaw an efficiency defence, the scope of acceptable efficiencies was defined so narrowly, that the defence did not play any role in practice.

The analytical framework of the Focus Cases proved to be a dead-end. Several of its deficiencies contributed to this outcome. First, the assumptions of harm underlying the various categories of conditional rebates were postulated. As the Focus Cases did not draw a dividing line between rebates leading to anti-competitive foreclosure and rebates which amounted to pro-competitive low prices, there was no way to gather evidence from the cases whether the presumption of harm was actually justified.

A similar absence of evidence existed in relation to the efficiency consideration. While the authorities and courts in the Focus Cases referred to “normal competition” and “competition on the merits”, they did not consider whether the presumptively harmful rebates were used by non-dominant firms which in turn would have supported an efficiency claim.

Furthermore, the framework did not build in any paths from an object to an effects analysis but resulted in a binary outcome, namely confirmation of the object abuse presumption or absence of abuse. The framework offered the unattractive choice between risk of significant over-enforcement or risk of significant under-enforcement (without an option of analytical fine-tuning).

The framework of the Focus Cases compares unfavourably with the object restriction framework developed under Article 101(1) TFEU, which includes important feedback mechanisms (such as adaptation of the object categories in light of “experience”) and is open, in the sense that it allows switching to an effects analysis if the consideration of “all circumstances” suggests plausible efficiencies. Such a dynamic and open framework would have allowed the authorities to reflect on new “experience” (including better economic insights) that conditional rebates will regularly involve both pro-and anti-competitive aspects and hence strongly points to an effects analysis.

Two strands of cases have shown an alternative path towards the assessment of conditional rebates: *Post Danmark I* and *Post Danmark II* advocate the direct application of an effects analysis while Intel preserves the object abuse framework of the Focus Cases but introduces a low threshold for switching to an effects analysis. What both strands of cases have in common is the use of a benchmark, namely the AEC benchmark, which allows the identification of actual or likely competitive harm.

Finally, in our view, there is merit in developing further (and more clearly) the concepts of object and effects abuse under Article 102 TFEU along similar lines to those set out by AG Bobek for Article 101(1) TFEU. Not only would this lead to a more consistent application of both provisions, it would also help better understand and, where necessary, re-position the various categories of abuse.

+ + +