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# Bundled Discounts and EC Judicial Review

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## **Bundled Discounts and**

### **EC Judicial Review**

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**I**n Article 82(d) of the EC Treaty, bundling and tying are considered possible abuses. According to Article 82(d), it is abusive to make “the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.” If bundling refers to situations where a package of two or more goods is offered, bundled discounts can be defined in a general manner as the practice of selling multiple products for a single price or, in a more restrictive manner, as the practice to economically (through rebate schemes) induce customers to only buy a bundle consisting of the two products.

The Community Courts' case law is rich with cases relating to tying or bundling practices in their classical economic form. However, the same cannot be said for the second acceptance of bundled discounts. A case similar to the U.S. case, *LePage's*,<sup>1</sup> for example, has not been addressed directly by the Community Courts (discussed in section I of this paper). As a consequence, the answer to the question of how to determine whether or not a bundled rebate is simply a form of price competition or an exclusionary

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<sup>1</sup> *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003) (en banc) [hereinafter *LePage's*].

conduct must be found in other case law relating to abusive rebate policies (discussed in section II).

## **I. BUNDLED DISCOUNTS IN A NARROW SENSE WERE NOT ADDRESSED DIRECTLY BY COMMUNITY COURTS**

In the U.S. case, *LePage's*, the complainant was the market leader for private-label transparent tape. The defendant, 3M, had a monopoly on the manufacture of Scotch tape. It also manufactured private-label tape and many other products, such as health care and automotive products. 3M's bundled rebate schemes offered progressively higher rebates when customers increased purchases across its multiple product lines. LePage's could not match these discounts because it did not offer the same diverse product line.

Similar circumstances can be found in the Community Courts' case law, but as mentioned at the start of this paper, these were not addressed thoroughly. In *Michelin v. European Commission*,<sup>2</sup> the European Court of Justice (ECJ) was called on solely to determine the validity of the Commission's decision which found that an extra bonus linked to sales targets on the market in car tires was in reality akin to a discount on sales of heavy-vehicle tires and constituted a linked obligation under Article 82(d) EC. The Commission considered that the undertaking in question, by way of the extra bonus, made obtaining an advantage on the market in heavy-vehicle tires, where it was in a dominant position, conditional on attaining a sales target on the separate market in car tires. However, the ECJ annulled the decision on that point, on the ground that the bonus at issue was granted according to a sales target set solely on the car-tire market and that

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<sup>2</sup> Case 322/81, NV Nederlandsche Banden Industrie Michelin v. Commission, 1983 E.C.R. 3461 [hereinafter *Michelin v. Commission*].

there was thus no link between the purchase of lorry tires and that of car tires. The in-depth question of the economic consequences of bundled rebate schemes was therefore not discussed.

In *Michelin II*,<sup>3</sup> the product market concerned was that of replacement tires for heavy vehicles in France which encompasses two relevant product markets, namely the market for new replacement tires and the market for retreaded tires. Only one of Michelin's rebate schemes directly related to bundled discounts was considered abusive by the Commission, namely the PRO rebate (offered under Michelin's "Agreement for optimum use of Michelin truck tyres"). In order to qualify for this rebate, a dealer had to sign a PRO agreement and already be receiving a progress bonus.<sup>4</sup> The dealer had to send used tires for retreading to Michelin exclusively. A flat-rate rebate was payable on every used tire sent. According to the Commission, this rebate produced a clear tied-sales effect in two ways:

1. Michelin was using its dominant position on the new tires market to strengthen its position on the market for retreaded tires; and
2. Michelin was using its dominant position on the retreaded tire market to strengthen its position on the market for new tires.

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<sup>3</sup> Case T-203/01, *Manufacture française des pneumatiques Michelin v. Commission*, 2003 E.C.R. II-4071 [hereinafter *Michelin II*].

<sup>4</sup> With regard to the progress bonus on new replacement tires, in the Commission's view, the bonus forced the dealer to commit himself to a minimum amount of purchases of new replacement tyres (called the base) corresponding either to the previous year's purchases or to the average of the last two or three years (with adjustments in coefficients).

Indeed, in order to qualify for the PRO rebate, the dealer had to sign a progress bonus agreement and, conversely, the number of PRO rebates was limited to the number of new replacement tires bought.

However, this rebate scheme and the findings of abuse relating to that particular scheme were not challenged by Michelin before the European Court of First Instance (CFI).

## **II. HOW TO APPRAISE BUNDLED DISCOUNTS ACCORDING TO THE COMMUNITY COURTS' CASE LAW REGARDING REBATES**

### **A. Bundled Rebates Are a Category of Fidelity Rebates “Above Cost”**

The “legal statute” of bundled discounts is different from that of tying and bundling and must be compared to that of fidelity rebates above costs. While there is no dispute between the experts in competition law that an undertaking holding a dominant position has a particular responsibility with regard to competition in its market, they differ as to whether or not rebates “above cost” to customers facing competition constitute a reaction that is compatible with that responsibility (i.e., when the prices in question are not predatory within the defined case law<sup>5</sup>).

According to the Community Courts' case law, rebates above cost can be considered unlawful if they produce a loyalty-inducing effect, are unfair, or produce foreclosing or exclusionary effects. Such rebates are indeed a relatively low-cost method for the undertaking holding a dominant position, to keep a customer from turning to the competition.

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<sup>5</sup> Case C-62/86, Akzo v. Commission, 1991 E.C.R. I-3359; Case T-83/91, Tetra Pak v Commission, 1994 E.C.R. II-755.

The Community Courts have consistently held that fidelity rebates granted by an undertaking in a dominant position are an abuse within the meaning of Article 82 EC where the aim is, by granting financial advantages, to prevent customers from obtaining their supplies from competing producers.<sup>6</sup>

The CFI indicated that “not all competition on price can be regarded as legitimate. [...]. An undertaking holding a dominant position cannot have recourse to means other than those within the scope of competition on the merits.”<sup>7</sup> The CFI took the view that:

[A] rebate granted by an undertaking in a dominant position by reference to an increase in purchases made over a certain period, without that rebate being capable of being regarded as a normal quantity discount [...] constitutes an abuse of that dominant position, since such a practice can only be intended to tie the customers to which it is granted and place competitors in an unfavourable competitive position.<sup>8</sup>

As a consequence, the Court and the CFI have systematically condemned rebates which can be considered target rebates. For instance, Michelin’s “quantity rebate” schemes fall in this latter category. In reaching a target (the threshold), the dealer benefited from a reward superior to his marginal contribution to the economies of scale, since the rebate was retroactively calculated as a percentage of the whole turnover made with Michelin over the reference period. The scale of thresholds was actually a succession of target rebates. For instance, in its judgment, the CFI provided a self-

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<sup>6</sup> *Michelin v. Commission*, *supra* note 2, at para. 71; Case T-228/97, *Irish Sugar v. Commission* 1999 E.C.R. II-2969, at para. 197 [hereinafter *Irish Sugar*].

<sup>7</sup> *Michelin II*, *supra* note 3, at para. 97.

<sup>8</sup> *Irish Sugar*, *supra* note 6, at para. 213.

explanatory example in which the rebate represented 7500 percent of the value of the supplementary purchase.<sup>9</sup>

Bundled rebates are likely to be assessed following the same pattern of analysis. Bundled rebates could create loyalty-inducing effects and place competitors in an unfavorable competitive position in two manners:

1. on the one hand, they could produce these effects whenever a rival simply could not match the rebate because it would not offer a comparable breadth of products;
2. on the other hand, the rate of rebate for the mix of products could not be matched by a competitor of the dominant undertaking.

The latter case could be found in the following situation:

- a rebate system applied to dealers and not to direct customers;
- an undertaking with a very strong and lasting dominant position in at least one of the markets;
- products of the dominant undertaking sold at a higher price than competitors in at least one of the markets;
- a market with strong demand from direct customers to dealers, privileging the dominant undertaking's products in at least one of the markets; and,
- a rebate scheme based on bundling (i.e., a rebate in one market being conditional to obtaining the rebate in another market).

To give an example, consider a dominant undertaking that sells its products to dealers active in markets A and B, and its competitors only sell products in market B. Assume that the dominant undertaking sells product A for 200 euros in market A and that, in market B, both the dominant undertaking in A and the competition sell product B

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<sup>9</sup> *Michelin II*, *supra* note 3, at para. 87.

for 100 euros. Assume further that the dominant undertaking in A and the competition in B can afford a 10 percent rebate for the whole range of products they have, the bundled rebate offered by the dominant undertaking in A will amount to 10 percent of 200 plus 10 percent of 100 (i.e., 30 euros), while the competition will offer the dealer only 10 percent of 100 (i.e. 10 euros). In order to match the bundled rebates of the dominant undertaking in A, the competition in B should offer 30 euros (i.e., 30 percent of the selling price of the B products), and at the same time, the financial effort of the dominant undertaking will be limited to 10 percent of its global selling price.

For the dominant undertaking in A, the enhanced capacity of offering a higher rebate through bundling, and by consequence the highest margin to dealers than any of the competition in market B, is likely to produce loyalty-inducing effect and to put competition in an unfavorable situation in market B.

### **B. Efficiency Defense or Per Se Infringements?**

In its staff paper on Article 82 EC,<sup>10</sup> the Commission states that a dominant company may invoke an efficiency defense. Indeed, tying and bundling may help to produce savings in production, distribution, or transaction costs that could be returned to customers as additional rebates to individual products consented rebates.

However, for the Community Courts, for the purposes of establishing an infringement of Article 82 EC, it is sufficient to show that the abusive conduct of the undertaking in a dominant position tends to restrict competition or, in other words, that the conduct is capable of having that effect. It follows that, for the purposes of applying

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<sup>10</sup> EUROPEAN COMMISSION, DG COMPETITION DISCUSSION PAPER ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO EXCLUSIONARY ABUSES (Dec. 2005).



that article, establishing the anticompetitive object and the anticompetitive effect of abusive conduct are one and the same. If it is shown that the intention of the conduct of an undertaking in a dominant position is to limit competition, that conduct will also be liable to have such an effect.<sup>11</sup>

These two approaches are of course reconcilable, but it shows that a dominant undertaking must supply an economic justification (e.g., that bundled rebates correspond to economies of scale) for the commercial schemes it puts in place, such as bundled rebates. For the Commission, it is sufficient to demonstrate that the behavior of the undertaking should, or is likely to produce, a restrictive effect on competition.

### **III. CONCLUSION**

This short paper follows a strict approach in defining bundled rebates. A larger approach would mean addressing a much larger scope of the Community Courts' case law. Quoting only a famous and recent example, the issue of offering Microsoft's Windows Media Player with a dominant operating system at no charge could be considered a bundled discount. However, it is worth noting that this approach was not followed by the CFI which considered the abuse a classical case of tying.

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<sup>11</sup> *Michelin II*, *supra* note 3, at paras. 108, 237-39, & 241.