# REBATES: FORMALISM, EFFECTS AND THE REAL WORLD

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## I. INTRODUCTION

Rebates by dominant undertakings are a controversial area in competition law. While they can be part of genuine price competition and lead to lower prices, they can be also used by dominant firms as a means to exclude competitors and effectively harm customers.

Under one approach, a rebate must be regarded as abusive if it is generally "loyalty enhancing," regardless of its concrete effects on the market. This rather formalistic approach derives from the traditional case law of European Union ("EU") courts[2] and is considered to be the prevailing view of jurisprudence to date.

Under another, more economic, approach, the practical effects of rebates should be assessed through economic tests and the rebates' impact on competition should be quantified ("effects-based approach").

## II. EU COURTS VS. EUROPEAN COMMISSION

According to the prevailing case law of EU courts to date, there is generally no need to demonstrate actual or even concrete anticompetitive effects for a rebate to qualify as an abuse of dominance under Article 102 TFEU. In fact, certain rebate schemes, when applied

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[2] See e.g. Case T-203/01 *Michelin II*; Case 85/76 *Hoffmann La Roche;* Case C-95/04P *British Airways.*

by dominant firms, may be automatically considered as abusive (e.g. exclusivity rebates).

However, the European Commission ("the Commission") has expressed its preference for the effects-based approach, both in its Guidance[3] and its recent decisional practice. With respect to rebates, as with other pricing practices, the Commission has adopted a methodology based on cost data and introduced the As-Efficient-Competitor ("AEC") test, which focuses on whether the rebate is likely to prevent competitors as efficient as the dominant firm from expanding or entering a market. In general, the Commission does not consider the rebate to be capable of anti-competitive foreclosure when the price remains above the long-run average incremental cost ("LRAIC") of the dominant firm. On the contrary, if the price is below the average avoidable cost ("AAC"), then the rebate scheme is considered capable of foreclosing even as-efficient competitors.

## III. THE RULING ON *POST DANMARK II*

Although the prevalent case law of EU courts and National Competition Authorities ("NCAs") to date generally follows the formalistic approach, a recent judgment of the Court of Justice of the European Union ("CJEU") on a preliminary ruling request, can be considered as a step towards the effects-based approach. It is also the first time that the CJEU recognized that the AEC test may be used for the assessment of rebates and there is no reason for its confinement to *stricto sensu* pricing abuses.

In Case C-23/14 ("*Post Danmark II*"), the CJEU initially repeated the dicta of traditional case law and identified three major categories of rebates:

a) Quantity rebates, linked only to the volume of purchases, which are not in principle considered to violate Article 102 TFEU, mainly because they are deemed to reflect the dominant firm's gains in efficiency and economies of scale;[4]

b) Loyalty rebates, which offer customers financial incentives to purchase all or most of their requirements from the dominant firm and which are generally considered abusive, mainly because they are deemed designed to prevent customers from dealing with competitors;[5] and

c) Mixed rebates, which are neither quantity nor loyalty rebates. According to the CJEU, this is the only category of rebates for which it is necessary to conduct a detailed analysis and to consider "all the circumstances, particularly the criteria and rules governing the grant of the rebate, and to investigate whether in providing an advantage not based on any economic service justifying it, the rebate tends to remove or restrict the buyer's freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties or to strengthen the dominant position by distorting

[3] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p. 7–20.
[4] See e.g. Case T-203/01 *Michelin II*.
[5] Case 85/76 *Hoffmann La Roche*, and Case T-155/06 *Tomra*.

competition."[6]

Despite this rather formalistic breakdown which relies on presumptions, in other parts of the judgment the CJEU seems to depart from this approach: it focuses on the analysis of effects and for the first time acknowledges the relevance of the AEC test with regard to rebates, in line with the Commission's view that this test should not be confined to *stricto sensu* pricing abuses.

In particular, the CJEU held that:

a) in order to establish abuse, one should demonstrate that "there is an anti-competitive effect which may potentially exclude competitors who are at least as efficient as the dominant undertaking"[7] and "the anti-competitive effect of a particular practice must not be purely hypothetical";[8]

b) "recourse to the AEC test in cases involving a rebate scheme for the purposes of examining its compatibility with Article 82 EC" should not in principle be excluded;[9] and

c) the AEC test is to be considered as "one tool amongst others for the purposes of assessing whether there is an abuse of a dominant position in the context of a rebate scheme."[10]

In the particular case however, the CJEU held that the AEC test was of no relevance due to its particularities (superdominance, legal monopoly, significant economies of scale, high entry barriers, etc.), which made the appearance of an AEC practically impossible. Of course this does not diminish the importance of the affirmation that the AEC test can be applied in rebate cases and there is no reason to be restricted merely to pricing abuses; it just demonstrates that the AEC test should not be automatically applied in all cases, but – as with any other assessment tool – an examination of all the surrounding circumstances is necessary to determine its applicability.

## IV. THE *HEINEKEN* CASE[11]

Contrary to the CJEU, the Hellenic Competition Commission ("HCC") did not appear equally broad minded when examining the relevant rebate scheme in the *Heineken* case.[12] This case concerned various commercial practices by Athenean Brewery S.A. ("AB"), a subsidiary of Heineken N.V. and the market leader in the Greek beer market, from 1998 to 2013.

Initially, it should be noted that market data during the 16-year investigation period

[6] See *Post Danmark II*, para. 29
[7] Case 23/14, para. 66.
[8] Id. para. 65.
[9] Id. para. 58.
[10] Id. para. 61.
[11] In the interest of transparency, it is disclosed that the author participated in AB's defense before the HCC. However, the views expressed herein are strictly personal.
[12] *Hellenic Competition Commission decision* No. *590/2014, published on 01.12.2015, available at* http://www.epant.gr/apofasi_details.php?Lang=gr&id=361&nid=746

indicated that no anti-competitive effects had come about: AB's market share reduced every year and by 2013 it shrunk by almost 30 percent;[13] the market shares of its competitors increased every year; there was successful market entry and expansion by new competitors;[14] and AB product prices had not increased nor accused to have increased to anti-competitive levels.

Despite such indications, the HCC refused to conduct any effects analysis and followed a rigidly formalistic approach, mainly invoking the standard case law of EU courts on exclusivity. While AB presented an expert's report with a full economic analysis of its price structure and its rebate scheme, which confirmed the lack of anti-competitive effects, the HCC rejected such analysis primarily as unnecessary.

In particular, the HCC held that AB applied exclusivity rebates, which are prohibited *per se* as abusive absent an objective justification. The HCC also added that exclusivity agreements by dominant undertakings lead to foreclosure by their nature and it is not necessary to examine their effects on the market.

However, the rebates granted by AB were not conditional on exclusivity; they were not connected with any particular purchase obligation of the customer; and there was no reference to the customers' purchase requirements. Despite these facts, the HCC concluded that AB's rebates were "exclusivity rebates" mainly because the proportion of AB products in the total of beer products distributed by its customers was high. The only explanation for this finding was, according to the HCC, that there was a de facto exclusivity agreement in place, according to which the rebates were granted. The fact that AB's products were the strongest and most popular beer brands in Greece was disregarded by the HCC as irrelevant.

Furthermore, the HCC held that AB pursued exclusivity mainly because the economic considerations granted to AB customers in the form of rebates were considered "high." The HCC reached such a conclusion essentially by comparing the rebates' arithmetic value with the customers' total gross turnover in AB products. Such method was quite innovative since it finds no grounds on the economic analysis conducted by EU courts or the Commission in similar cases.

The rigidly formalistic approach followed by the HCC and its refusal to look into the effects of the practices in question was a very bold choice, considering that the EU courts generally hesitate to take such a rigid position. Even in cases where the formalistic approach was adopted with regard to exclusivity, the effects likely to be produced by such practices were actually examined and appraised in the particular circumstances of the case.[15] Actually the same line was followed by the HCC itself in the preceding cases of Nestlé[16] and Tasty.[17]

## V. IS FORMALISM A SUITABLE APPROACH TO ASSESS REBATES?

[13] From approx. 80 percent in 1998 it shrunk to approx. 54 percent in 2013.
[14] Indicatively, a new entrant gained a 14 percent market share within 3 years.
[15] See indicatively Case C-549/10P *Tomra*; Case T-201/04 *Microsoft*; Case C-95/04P *British Airways*
[16] Case 434/V/2009, available at: http://www.epant.gr/apofasi_details.php?Lang=gr&id=289&nid=543
[17] Case 520/VI/2011, available at: http://www.epant.gr/img/x2/apofaseis/apofaseis667_1_1329733817.pdf

The formalistic approach adopted by the HCC in the Heineken case and the traditional EU case law, presents, in the author's view, serious disadvantages and it is not necessarily apposite for the assessment of rebates. On the contrary, more steps towards the effects-based approach are necessary, in the same direction as that followed in *Post Danmark II*.

In brief, one could challenge the suitability of formalism when addressing rebates mainly because:

*A. In Principle All Types of Rebates May Lead to Foreclosure*

Similarly, all types of rebates may be pro-competitive. Hence, a general maxim that quantity rebates are legal, loyalty rebates abusive and only mixed rebates should be subject to analysis does not necessarily depict their true effect. In principle all types of rebates should be analyzed.

*B. "Type" Analysis of Rebates Contradicts the Approach of Case Law to Low Pricing Practices*

The effects analysis has been repeatedly applied by the EU courts to low pricing practices, such as selective pricing,[18] predatory pricing[19] and margin squeeze.[20] It is unclear what is the major difference between rebates and those pricing practices, which justifies a diverse treatment in their analysis, and why the effects approach cannot in principle be applied on all rebates irrespective of their "type."

*C. Exclusivity rebates*

1. No obvious reason to be considered abusive by nature

It is not obvious why exclusivity is presumed to pursue anticompetitive purposes and why an objective justification is required to rebut such a presumption. All the more so, since EU courts in their Article 101 TFEU case law and the Commission in its Guidance and its Guidelines on vertical restraints[21] have acknowledged that exclusivity produces benefits for both the supplier and the distributor. It would appear contradictory to take these benefits into account when addressing a dominant firm's conduct under Article 101 TFEU, but disregard them and attribute anticompetitive intent instead, when addressing the same under Article 102 TFEU.

2. Presumptions of abuse due to exclusionary effect contradicts EU case law

Both in *Post Danmark I* and in *Telia Sonera*, the CJEU held that not every exclusionary effect is detrimental to competition and that "competition on the merits may, by definition, lead to the departure from the market or the marginalization of competitors that are less efficient and so less attractive to consumers."[22] Consequently, arguing that exclusion equals abuse without any further analysis appears inconsistent with EU case law and is an insufficient reasoning for such finding.

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[18] See e.g. Case C-209/10, *Post Danmark I.*
[19] See e.g. Case C-62/86 *AKZO*; Case C-202/07 P, *France Télécom.*
[20] See e.g. Case C-52/09 *Telia Sonera.*
[21] Commission notice - Guidelines on Vertical Restraints, SEC(2010) 411 final.
[22] *Post Danmark I,* para. 22; See also by analogy *Telia Sonera,* para. 43

*D. Formalism Ignores Commercial Reality, Market Conditions and Economic Evidence*

One could further argue that the formalistic approach ignores the reality of the market under consideration and is instead based on assumptions and theory. It appears rather exaggerated to suggest that a presumption is so infallible that it is unnecessary to look into the commercial reality, economic evidence, market conditions, and the evolution of business practices or market studies and reject all relevant considerations using the same criteria as decades ago in *Hoffman La Roche*. Effectively, assumptions and presumptions are the easiest way to protect competitors altogether, irrespective of their efficiency (or lack thereof).

*E. Formalism Does Not Contribute to the Evolution of Law*

The fact that Article 102 TFEU does not have such a strict wording or conditions as Article 101 TFEU, allows for a more constructive application thereof, leaves room for economic analysis and the examination of each market according to its particularities. However, the formalistic approach and the labeling of certain practices as "abuses by nature" prevents any evolution of the law and appears estranged from the complexity of current business transactions.

*F. Peril of Over-Enforcement*

The formalistic application of Article 102 could also result in over-enforcement, deter undertakings from charging lower prices based on rebates and unnecessarily restrict their freedom to determine their pricing policy.

*G. Against the Right to a Fair Trial and the Presumption of Innocence*

One could finally argue that the use of presumptions when applying provisions with a punitive or quasi-punitive character, like antitrust provisions, violates the primary right of the defendant to a fair trial and effectively inverts the presumption of innocence to a presumption of guiltiness.

## VI. REAL ISSUES FOR PRACTITIONERS

Apart from those objections to formalism on a theoretical level, its adoption by EU courts and NCAs, as well as the inconsistencies often noted in their decisional practice, has also created some very "real" problems for practitioners.

More often than not, a client who happens to be a dominant undertaking does not have exclusionary intent. Just like any firm, they wish to increase their market share, even to win over customers of their rivals. In fact, this is a manifestation of genuine competition on the merits. While, however, it is plausible to try to attract the customers of competitors, it is punishable to foreclose them; the borderline between the two is very thin, yet the classification of the conduct has very serious consequences.

But in the real world such categorizations and "labels" are often artificial or even inaccurate. For instance, a rebate which leads to de facto exclusivity is presumed abusive, but a selective price cut addressed only to a competitor's client is not. Are those two practices so different in reality to justify such diverse treatment in their analysis? Is the intent of the

undertaking so diverse in each of the two cases? Hardly so.

Besides, clients who request advice usually submit their commercial policy as a whole and do not generally pursue different goals by different practices (e.g. pricing practices vs. rebates vs. etc.). It appears impractical and even unrealistic to have to break down those practices into predetermined categories, artificially attribute different intent of the client to each practice and then follow a completely different method of analysis according to each presumed intent.

Especially with regard to rebates, it is quite a challenge to explain to a client the rationale of analysis that formalism dictates. Namely, that if the client grants rebates which can be considered to favor exclusivity, she will be presumed to have exclusionary intent and the rebates' effects will be irrelevant; if she gives some other type of rebates, like mixed rebates, no presumptions on her intent will be made and the rebates' effects will be relevant; and that if she manages to grant simple quantity rebates then her intent will be presumed not to be anticompetitive and again the rebates' effects will be considered irrelevant.

And to make things worse, one must also explain to clients that they would be somewhat "better off" if their commercial policy is examined by the EU Commission, because it generally looks into the effects of business practices; if the same policy is appraised by EU courts, then the client should not be too optimistic; and if the same is appraised by a NCA then… no one can be really sure about the approach to be followed.

If one imagines such conversations in the real world, between a real client and a real lawyer, it is not hard to see the distance between formalism and business reality.

## VII. CONCLUDING REMARKS

In view of the shortcomings one could attribute to the formalistic approach to rebates and taking into account the recent decisional practice of the Commission and the CJEU which seems to depart therefrom, further steps are welcome towards a wider adoption of an effects-based approach.

Applying Article 102 TFEU using the same criteria as those expressed decades ago, disregarding all the experience gained in-between and ignoring the development and diversity of current business models appears counterproductive and estranged from commercial reality.

Indeed, the decisional practice of EU courts and NCAs that neglects effects, like the recent *Heineken* decision of the HCC, can make the application of competition law a simplistic and mechanical process, deter innovation and practically encourage undertakings to adopt the same business policy (e.g. simple quantity rebates), just to be "on the safe side."

Case law evolves and is subject to change. Courts do take into account their past judgments but they are not legally obliged to follow them. Hopefully, thus, a change of course away from formalism and towards effects is not too far away, the CJEU judgment in *Post Danmark II* just being the starting point.