CPI's Europe Column Presents:

Rebates: Formalism, Effects and the Real World

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1. Introduction

1. 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 ultimately harm customers.

2. Under one approach, a rebate must be regarded as abusive under Article 102 TFEU if it is generally "loyalty enhancing", without the need to demonstrate actual or even concrete anticompetitive effects on the market. This rather formalistic approach derives from the traditional case law of EU courts[1] and is considered to be the prevailing view of jurisprudence to date.

3. Under another approach, the practical effects of the rebates should be assessed through economic tests and the rebates' impact on competition should be quantified. The European Commission ("the Commission") has expressed its preference for this effects-based approach, both in its Guidance[2] and its decisional practice ever since. As with other pricing abuses, the Commission has introduced the As-Efficient-Competitor ("AEC") test, which focuses on whether the rebate is likely to prevent competitors that are as efficient as the dominant undertaking from expanding or entering a market.

2. Post Danmark II

1. Although the prevailing 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"), concerning a preliminary ruling request from the Danish courts, can be considered as a step towards the effects-based approach.

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

a) *Quantity rebates*, linked solely to the volume of purchases, which are not in principle considered to violate Article 102 TFEU; [3]

b) *Loyalty rebates*, which offer customers financial advantages in order to purchase all or most of their requirements from the dominant firm, and which are generally considered to infringe Article 102 TFEU; [4] and

c) *Mixed rebates*, which are neither quantity nor loyalty rebates, and this is the only category of rebates for which a detailed analysis of effects is necessary.

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

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

[2] 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.

[3] See e.g. Case T-203/01 *Michelin II*.

[4] Case 85/76 *Hoffmann La Roche*, and Case T-155/06 *Tomra.*

4. In particular, the CJEU held that:

i) 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*"[5] and "*the anti-competitive effect of a particular practice must not be purely hypothetical*";[6]

ii) "*recourse to the AEC test in cases involving a rebate scheme for the purposes of examining its compatibility with Article 82 EC*" should not be in principle excluded;[7] and

iii) 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*".[8]

3. Is formalism a suitable approach to assess rebates?

1. For the reasons described above, the judgment on Post Danmark II can be considered as a step towards the effects-based approach. This is a much welcome development, since the adoption of formalism by the majority of case law to date presents, in the author's view, serious disadvantages and is not necessarily suitable for the assessment of rebates.

2. In brief, one could argue that:

i) In principle all types of rebates can lead to foreclosure

Similarly, all types of rebates can 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.

ii) The analysis of rebates according to their "type" 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,[9] predatory pricing[10] and margin squeeze.[11] 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 rebates altogether, irrespective of their "type".

iii) Exclusivity rebates

a) 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 Art. 101 TFEU case law and the Commission in its Guidance and its Guidelines on vertical restraints[12] have acknowledged that exclusivity produces benefits for both the supplier and the distributor. It would appear contradictory to take these benefits into account

[5] Case 23/14, para. 66.
[6] Id. para. 65.
[7] Id. para. 58 .
[8] Id. para. 61.
[9] See e.g. Case C-209/10, *Post Danmark I.*
[10] See e.g. Case C-62/86 AKZO; Case C-202/07 P, *France Télécom.*
[11] See e.g. Case C-52/09 *Telia Sonera.*
[12] Commission notice - Guidelines on Vertical Restraints, SEC(2010) 411 final.

when addressing a dominant firm's conduct under Art. 101 TFEU, but disregard them and attribute anticompetitive intent instead, when addressing the same under Art. 102 TFEU.

b) 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 marginalisation of competitors that are less efficient and so less attractive to consumers*".[13] Consequently, arguing that exclusion equals abuse without any further analysis appears inconsistent with EU case law and is ultimately insufficient reasoning.

iv) 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, the evolution of business practices or market studies and reject all relevant considerations using the same criteria to assess business conduct as done decades ago in *Hoffman La Roche*.

v) Formalism does not contribute to the evolution of law

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

vi) Peril of over-enforcement

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

vii) Against the right to a fair trial and the presumption of innocence

One could finally argue that the use of presumptions with regard to provisions having 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, against which an objective justification by the defendant is necessary.

4. Real issues for practitioners

1. 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, also pose some real problems for practitioners.

2. 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. However, while it is plausible to try to attract the customers of competitors, it is punishable to foreclose competitors: the borderline between the two is very thin, but the characterization of the conduct has very serious effects in practice.

[13] *Post Danmark I,* para. 22; See also by analogy *Telia Sonera,* para. 43

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

4. 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 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.

5. 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, further steps are welcome towards a wider adoption of an effects-based approach.

Applying Art. 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 modern business models appears counterproductive and estranged from commercial reality.

Indeed, the decisional practice of EU courts and NCAs that neglects effects can make the application of competition law a simplistic and mechanical process, deter innovation and practically encourage undertakings to adopt the same business policy, namely 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.