MFN CLAUSES, FIDELITY REBATES, AND LOYALTY PROGRAMS IN THE DIGITAL ERA: CURRENT STATUS, AND A LEGAL LACUNA?

MIND THE LACUNA

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CPI ANTITRUST CHRONICLE
SEPTEMBER 2019

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I. INTRODUCTION

MFNs and other measures which can reduce customer incentives to switch, such as fidelity rebates, have long been a complex area of European and wider antitrust laws. There is a renewed focus on these clauses, given the prevalence of MFNs in two-sided digital platform markets, and the ECJ's landmark decision in *Intel*. As regulators struggle to get to grips with the implications of the digital economy for competition law, different authorities, including within the EU, have taken seemingly contrasting approaches. This article seeks to evaluate the recent developments and shed some light on the current status. Finally, we ask whether the growing importance of big data, amassed in part by consumer-level loyalty programs, suggests a lacuna in the current EU and UK approach to dominance.

II. MFNS

A. MFN Clauses: Framework for the Analysis

So-called "most favored nation" ("MFN"),[2] "meeting competition" or "most favored customer" clauses require that if the grantor of the MFN offers any improved pricing or changed or better terms elsewhere, it should also offer those terms to the beneficiary of the MFN clause. MFNs may be "wide" or "narrow." A wide MFN is one which applies across the board to capture better pricing offered anywhere by the counterparty; a narrow MFN applies to capture only better pricing offered on the counterparty's website. More on the distinction between the two is provided below.

MFNs may have implications under both Articles 101 and 102 TFEU, when engaged in by dominant firms. As regards Article 101 TFEU, it is clear that MFN clauses do not fall within the narrow category of "by object" restrictions. "By object" restrictions are those – such as price fixing, market sharing or bid-rigging – which are viewed as sufficiently pernicious to be classed as being "by their very nature" restrictive of competition. Agreements which are not "by object" restrictions are assessed for restrictive "effects" on competition. Discussion of MFNs necessarily therefore focuses on their potential to have demonstrable negative effects on competition in a given market or markets.

An obvious consideration is that such clauses may not be entered into for anti-competitive purposes (i.e., the beneficiary may simply be anxious to ensure that it is getting the best deal). However, intent is not a necessary element in establishing a restriction of competition "by effect." The European Commission (the "Commission") has gone some way to recognize this potential for a benign motivation. In its Guidelines on the assessment of horizontal mergers, the Commission, in discussing coordinated effects, refers to:

2 The term MFN derives from WTO law, which (broadly) requires members to apply tariffs to all nations on the basis of the best terms they have offered to any nation.

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> [p]ractices which have the effect of easing the monitoring [of deviations from a tacitly coordinated norm] … even when these practices are not necessarily entered into for such purposes. These practices, such as meeting-competition or most-favoured-customer clauses … may increase transparency or help competitors interpret the choices made.[3]

As this suggests, the Commission's guidance has typically treated MFNs as having the potential to reduce incentives to compete on price or other terms, to foreclose competitors (particularly when entered into by dominant firms), and as a potential "…'supportive' measure to make maximum or recommended resale prices work as RPM."[4] This theory of harm is elaborated on in the Commission's Guidelines on technology transfer agreements, for example, which note that:

> [d]irect or indirect price fixing can be made more effective when combined with measures that reduce the licensee's incentive to lower its licensing price, such as the licensor obliging the licensee to apply a most-favoured-customer clause … an obligation to grant a customer any more favourable terms granted to any other customer.[5]

In the digital markets context, scraping tools and pricing algorithms have amplified these concerns and made it easier to detect deviations across a wide range of products.

Despite these clear indications in the Commission's guidance as to its concerns over the potential for MFN clauses to have restrictive effects, it is notable that the majority of EU and national competition authority ("NCA") investigations into MFNs have ended with settlements, or been closed with the agreed or voluntary withdrawal of the clauses (a 2017 fine of EUR 1 million imposed on Expedia by the French courts was an exception). This is likely to be because of the difficulty of demonstrating the necessary adverse effects on competition. However, the Commission clearly continues to believe that MFN clauses are capable of having restrictive effects contrary to Articles 101 and 102 TFEU, even if that belief has not yet been tested before the European courts. In a speech by Margarethe Vestager, the European Commissioner for Competition, on June 3, 2019 at the OECD/G7 conference, she described MFNs in highly negative terms, as clauses "which big platforms use to stop sellers from selling cheaper elsewhere, or offering different, more innovative products." Commissioner Vestager stated that she "fully agree[d]… that the Commission will need to watch this issue very closely in the years to come."[6]

B. Amazon E-books – An Example

These price competition softening, market transparency-increasing concerns were reflected in the approach taken by the Commission in *Amazon E-books* (2014 – 2017). *Amazon E-Books* concerned parity clauses between Amazon, a retail provider of e-books, and e-book suppliers. The clauses applied to a wide range of parameters including agency commissions, stock and functionality offered (selection), business models, promotions and pricing. The Commission found that such terms could result in a loss of innovation by suppliers, as well as restricting competition at the retail level.

At the supplier level, for example, the Commission found that selection parity clauses meant that suppliers had a reduced incentive to work with other retailers to develop novel functionality, as suppliers knew that they could also be required to develop Amazon e-reader-compliant versions of any new features/functions. Similarly, in the Commission's analysis, business model parity clauses reduced suppliers' incentives to work with other retailers to develop and support different business models (such as subscription-based pricing). Price and promotion parity clauses reduced suppliers' incentives to agree lower prices elsewhere, for example, in response to a retailer offering to charge a lower commission – as the supplier would know that, under the parity clause, they would be likely to need to replicate the lower pricing offer with the largest retailer, Amazon, without the reduced commission. By reducing the options available to Amazon's retail-level competitors to use innovative models or offer increased functionality or lower prices compared to those available via Amazon, Amazon's retail level competitors were also rendered less able to compete effectively with Amazon.

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3 Commission Guidelines on the Assessment of Horizontal Mergers, para. 51.

4 Commission Guidelines on Vertical Agreements, para. 48.

5 Commission Guidelines on Technology Transfer Agreements, para. 118.

6 M. Vestager, "Competition and the Digital Economy," Paris, June 3, 2019, https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/competition-and-digital-economy_en.

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C. National Approaches

NCAs have also been active in this area, across the EU and beyond. An example is in online hotel booking platforms. Investigations began in 2012 into the use of clauses in contracts between booking platforms, such as Booking.com or HRS, and hotels, which provided that the booking platform must receive the "best price" available anywhere. The clauses were ultimately assessed by 25 national authorities within the EU. This resulted in a variety of national approaches.

In April 2015, for example, the national authorities of Italy, France and Sweden reached a settlement with Booking.com over the clauses, prohibiting wide but allowing for narrow MFNs. By contrast, in Germany, investigations closed with the prohibition of both wide and narrow MFNs. This approach has just been partly overturned on appeal, as the Higher Regional Court of Dusseldorf found on 4 June that narrow MFNs only were permissible.

Other investigations, in Austria, Denmark, France, Greece, Ireland, Italy, Norway, Poland, Sweden and the UK were settled or closed without action when the firms concerned withdrew the clauses. Subsequently, however, the Swiss, French, Italian and Austrian governments went on to ban the use of wide and narrow MFNs. Outside those jurisdictions in which MFNs have been explicitly prohibited, however, the position remains that an effects-based analysis is required. The apparent hardening of views in Switzerland, France, Italy and Austria, and the range of approaches taken by decision-makers across the EU, exemplifies the complexities of this area.

D. MFNs and the Digital Economy

The rise of the digital economy has re-energized many interesting areas of antitrust law. MFNs are one of these, as can be seen from the hotel booking cases, and from Commissioner Vestager's June 3, 2019 speech.[7] Two-sided platforms have become increasingly central to the consumer experience since the digital revolution, and controversy over MFNs now most commonly arises in these markets. To date, outside the hotel booking context, investigations have taken place in online auction services, online shopping sites and in price comparison websites of various types. In the UK, these investigations have closed with commitments (*online auction services*[8]) or remain ongoing (*CompareTheMarket*[9]). MFN clauses were also among the points considered in the recent market study by the UK Financial Conduct Authority ("FCA") into investment platforms, carried out as part of the exercise of its concurrent competition powers. The FCA noted that MFNs "…could create an explicit constraint on the prices a fund manager can set for its own funds across different platforms."

As concerns the potential for restrictive effects on competition, a key fault line lies in the distinction (or lack of it) between wide and narrow MFNs. Some authorities, such as those of Sweden, Italy and Ireland, have distinguished "wide" from "narrow" MFNs. Where the distinction has been made, as in the UK (in the investigation by the Competition and Markets Authority ("CMA") into private motor insurance), Sweden, Italy and Ireland, the approach has generally been to condemn wide MFNs but allow narrow MFNs. However, the Swiss, French, Italian and Austrian prohibitions referred to above apply across the board to MFNs, whether wide or narrow. The criticism attracted by the divergent nature of these approaches, and the resultant uncertainty for business, may be one reason why Commissioner Vestager has sought to place the Commission front and center of the agenda on MFNs.

As it stands, however, this cross-EU patchwork of regulatory approaches gives multi-national companies selling across borders a difficult dilemma. One possible approach is to adopt the most stringent regulatory standpoint and to drop the use of the clauses across European (or wider) operations. This is the approach adopted by Amazon, which dropped its use of the clauses in e-books, first across the EU and then worldwide following investigations in the EU and in Japan. Amazon is now the subject of calls in the U.S. for renewed scrutiny of its wider use of such clauses.[10]

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7 *Id.*

8 CMA investigation, *Auction services: anti-competitive practices,* https://www.gov.uk/cma-cases/auction-services-anti-competitive-practices.

9 CMA investigation, *Price comparison website: use of most favoured nation clauses,* https://www.gov.uk/cma-cases/price-comparison-website-use-of-most-favoured-nation-clauses.

10 https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1052515&siteid=190&rdir=1.

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However, though this approach has the potential benefit of simplicity, it could also leave a company at a commercial disadvantage, particularly where rivals have taken a more bullish approach to the risk. A company could find itself in a position whereby it is especially difficult to negotiate preferential terms, as the counterparty knows that any better terms must instantly be offered to all rivals – and yet, the company may not itself benefit from better terms achieved by rivals. In addition, a price comparison website, for example, may rely on MFNs to allow it to state with confidence to users that it shows the best prices. However, in the CMA's investigation into private motor insurance, for example, the CMA states that though this argument had some currency as regards narrow MFNs (i.e. the price comparison website's offering should not be undermined by lower prices on the insurer's own website), it found that consumers did not expect prices shown on price comparison websites to be the lowest available, and instead shopped around on multiple sources including other price comparison websites, to get the lowest quote. It will be interesting to see how this is addressed in the CMA's ongoing investigation into comparison website, ComparetheMarket.

Another approach is to retain the clauses in those jurisdictions where they have not been prohibited outright. A company taking this approach will need to accept the attendant uncertainty as to whether its terms are enforceable – as well as the risk of wasted management time and costs in any future investigation.

In some markets, there may be a more nuanced approach to be taken here. Within the EU, in a cross-border market characterized by several strong competitors, where each party to the agreements which contain the MFN has a market share of 30 percent or less, the Block Exemption for Vertical Agreements ("VBER") will apply. The beneficiary in particular will then need to keep under review not only its own but the counterparty's market share, to assess whether the 30 percent safe harbor may be exceeded. A grace period of one year for shares exceeding 35 percent and two years between 30 and 35 percent applies to allow for adjustment. However, the Commission is entitled to disapply the VBER where networks of similar restraints cover over 50 percent of the market, so a company reliant on the perceived availability of the VBER to mitigate potential risk arising from its use of MFN clauses will also need to be mindful of what others in its market are doing.

Some of these complexities should be addressed in the Commission's review of the VBER.[11] The VBER is set to expire in May 2022 and the review is currently ongoing. A much-anticipated staff working document is planned for Q2 2020 and should shed further light on the Commission's proposals.

III. LOYALTY PROGRAMS AND FIDELITY REBATES

One key focus of companies in agreeing MFNs can be how to make customers more "sticky," by making price promises more attractive and thus reducing customers' incentive to go elsewhere. A second way in which companies may seek to cement relationships with customers is through offering discounts and rebates. Generally, such practices are unproblematic and even pro-competitive when engaged in by non-dominant firms – maximizing consumer welfare through lower pricing being a key focus for European competition law.

However, conditional rebates (as opposed to unconditional discounts) can be structured to induce loyalty or fidelity. Abusive, loyalty-inducing rebates are typically viewed as those which are individualized and retroactive rather than standardized and incremental (though, as always in this area, few rules are hard and fast over time – standardized incremental rebates were at issue in *Michelin II*), and/or which are designed, e.g. by applying only over a certain individualized volume, to ensure that all or the majority of a particular customer's requirements are focused with the dominant firm. The Commission has taken the view that these are akin to exclusive dealing. In the Commission's view, loyalty-inducing rebates can have the effect of foreclosing competitors, leveraging the dominant firm's sway over the non-contestable portion of demand to charge an effective price for the contestable portion of demand that would be uneconomic for its remaining as-efficient competitors, and deterring customers from switching the small portion of contestable demand away from the dominant firm.[12]

After receiving criticism for an apparently rigid or "per se" approach to the assessment of such rebates, the Commission stated in its 2009 Guidance Paper[13] that it may also assess whether the effective price, taking into account the rebate, is such as to exclude an as-efficient competitor to the dominant firm. The question is, essentially, would a competitor need to offer goods at below cost in order to compete with the

11 https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1100634&siteid=190&rdir=1.

12 Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings, para. 39 (the "2009 Guidance Paper").

13 *Id.* para. 41-45.

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dominant firm for that customer's demand? The Commission states that effective prices below AAC[14] will be assumed to have this exclusionary effect; between LRAIC[15] and AAC, the Commission will assess the availability of effective counterstrategies by competitors and the likelihood that entry or expansion by as-efficient competitors will be affected.

The *Intel* case exemplifies the shifting sands of EU competition law and policy in this area.[16] Despite the effects-focused approach taken in the 2009 Guidance Paper, the Commission appeared to argue that exclusivity rebates were akin to a "by object" infringement when put in place by a dominant firm, as no demonstration of foreclosure effects was required. In its landmark 2017 judgment, the European Court of Justice ("ECJ") overturned this approach. The ECJ noted the presumption that loyalty-inducing rebates, which tie purchasers to obtain all or most of their requirements exclusively from one supplier, may constitute an infringement when agreed by a dominant firm. However, the ECJ found that where a dominant firm argued that there was no adverse effect on competition as a result of the provision, the Commission must assess factors including the extent of the dominant position, the share of the market covered by the rebate, the conditions for application of the rebate including the amount and the duration, and whether there was any evidence of intent to exclude an as-efficient competitor. Finally, the Commission is required to consider whether any foreclosure effects may be outweighed by efficiencies benefiting the consumer. The *Intel* case has been viewed as an exemplar of the increasing importance of economic analysis in antitrust.

A. Big Data and Loyalty Programs: A Gap in the Law?

Most consumers will be most familiar with loyalty rebates in the form of loyalty programs for supermarkets, coffee shops and other chains, big and small. Customers collect points for each purchase, redeemable against future shopping. Customers may also receive targeted mailshots with particular promotions, and, thanks to the data collected, it is now possible for these to be targeted with a high degree of specificity.[17] As consumer consciousness grows over the collection and storage of personal data by household name brands, the interaction of personal data with competition law becomes ever more relevant. The twists and turns of the ongoing *Facebook* case in Germany have attracted considerable interest in this regard – at the time of writing, the Higher Regional Court of Dusseldorf had just suspended the application of the German authority's landmark decision, to the effect that Facebook's data collection practices constituted an abuse of dominance. The preliminary judgment appears to call into question the newly-forged link between data privacy and Article 102 TFEU.

Antitrust concerns in this area typically focus on two main points: i) the potential for vast banks of amassed data to support dominance, deter entry and inhibit expansion; and ii) the capacity for data to be used to deter switching by customers. The latter is most often discussed in the context of social media. On such platforms, so the theory goes, users may be deterred from switching to new platforms by the difficulty of moving amassed photographs and contacts with them. Similarly, entrant platforms may find it difficult to be as attractive to users as incumbents, lacking familiarity with each customer's long-established, incrementally built up news and advertising preference profiles. The UK Government's Furman Report (the "Furman Report") added to the calls for data portability as a solution to such concerns.[18]

Sectors which currently remain primarily bricks and mortar, such as supermarkets, where loyalty programs are most often encountered, remain highly competitive in the UK. However, it is not difficult to picture a situation in which a single supermarket digitizes more effectively than rivals, and quickly gains a large, but possibly not dominant, percentage of customer spend. Could the data it amassed on those customers enable it to offer targeted, conditional promotions, with fidelity rebates on frequent purchases (say household staples such as bread or milk, often already used by supermarkets as loss leaders) sufficiently attractive to foreclose competitors? Below cost pricing of this nature, funded by a sufficiently deep-pocketed investor base, could help exclude remaining as-efficient competitors.[19]

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14 Average Avoidable Cost.

15 Long Run Average Incremental Cost.

16 Case C-413/14 P *Intel Corporation Inc. v. Commission* (September 6, 2017).

17 C. Duhigg, *How Companies Learn Your Secrets*, New York Times, February 19, 2012, https://www.nytimes.com/2012/02/19/magazine/shopping-habits.html.

18 *Unlocking digital competition: Report of the Digital Competition Expert Panel*, March 2019, Recommended Actions 2 and 3, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

19 Uber, for example, is understood to have raised at least USD 14 billion in venture capital funding, along with USD 6 billion in debt. *See* Heather Somerville, *Cashing out in Uber's IPO: China, Russia and the Middle East*, Reuters, May 10, 2019, https://uk.reuters.com/article/uk-uber-ipo-investors/cashing-out-in-ubers-ipo-china-russia-and-the-middle-east-idUKKCN1SG0CJ.

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Some new economy firms have attracted significant investment, with investors seemingly content that such firms should remain loss-making for lengthy, multi-year start up periods.[20] In our hypothetical online supermarket example, similar investor loss insensitivity could allow for the funding of such a promotional campaign. Once dominance had been achieved, the strategy could be continued as needed to maintain the position gained – leveraging the ever-increasing amounts of data gleaned from the loyalty program, in a closely targeted manner. It no longer seems far-fetched to envisage narrow targeted promotions focused, for example, on customers living close to a key bricks and mortar alternative supplier, or (as tracked by cookies) showing a propensity to search on competing providers' sites, to foreclose competitors from the residual share of demand. In addition, as noted in the Furman Report, personalized pricing could also be deployed to the detriment of consumers, particularly after dominance had been obtained – perhaps as part of a more tailored recoupment strategy.[21]

The EU guidance focuses, as stated above, on the potential for a dominant firm to exclude an as-efficient competitor. Competition law in the EU and UK already has the tools available to address predatory pricing and the abusive use of loyalty-inducing measures – but only when engaged in by firms which are dominant. By contrast to the U.S. Sherman Act, for example, under which monopolization itself can be impugned, there is arguably a gap in UK and EU law for non-merger, unilateral steps taken on the road to dominance. This has been brought sharply into relief by the rapid growth of new technology players such as Facebook and Uber.

IV. CONCLUSION

Antitrust authorities worldwide are still in the process of coming to terms with the transformational potential of the digital economy for competition law. Given the cross-border, cross-jurisdictional nature of digital markets, cooperation between authorities will be critical. The fast emergence of new markets and the ability for new players rapidly to gain large shares of demand, presents a serious challenge to current antitrust models. Such innovation has brought considerable benefits to consumers, in terms of increased convenience and new products and services. Antitrust authorities are anxious to safeguard the innovative potential of markets – hence the concern over Amazon's business model parity clauses, which the Commission found likely to stifle service delivery innovations such as subscription models in the e-book sector – and the related questions raised by the Furman report over possible under-enforcement in merger control in the digital sector. In addition, authorities will be increasingly alert to the possibilities of network effects and tipping towards dominance, though these can be difficult to address using current tools. In the UK, among the many other topics we can expect to see on its agenda, the possibility for consumer level loyalty programs to leverage big data to restrict competition could be a worthy initial priority for the Furman Report's mooted Digital Markets Unit.[22]

20 See Alexis C. Madrigal, The Atlantic, April 2019, *The Uber IPO Is a Landmark*, https://www.theatlantic.com/technology/archive/2019/04/ubers-ipo-historic-despite-its-10-billion-loss/586999/; Financial Times, *Uber: Loss Decade,* August 8, 2019, https://www.ft.com/content/8b5d1150-ba47-11e9-8a88-aa6628ac896c; Lina M. Khan, *Amazon's Antitrust Paradox*, 126 Yale L.J. (2016).

21 Furman Report, *supra*, note 18, para, 3.164 – 3.168.

22 *Id.,* Strategic Recommendation A.

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