

Rebates Revisited: Anti-Competitive Effects and Exclusionary Abuse Under Article 82¹

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Rebates—retroactive discounts applicable where a customer exceeds a specified target for sales in a defined period—feature in many of the decided cases under Art.82 EC Treaty involving “exclusionary abuse”. The treatment of rebates features yet again in two recent judgments by the European Court of First Instance (“CFI”). These cases are particularly significant because they address a question that had not previously been explicitly considered by the Community courts—the extent to which exclusionary abuse under Art.82 requires some showing of anti-competitive effects. In these two cases, the CFI has ruled that Art.82 does not require a showing that a practice is likely to have anti-competitive effects such as a reduction in output or an increase in prices. In the view of the CFI, it is sufficient that a practice is “loyalty-enhancing”, *i.e.* that it creates an incentive for customers of a dominant firm to continue purchasing from that firm. This minimalist threshold for finding abuse accentuates the difference between Art.82 and the comparable provisions in US antitrust law. It reflects the persistence of a “structuralist approach” to Art.82, in contrast to Art.81 where a more economics based approach now prevails.

1 This paper is a revised version of a paper entitled: “Discounts as Exclusionary Abuse under Article 82: Reflections on Gyselen” which was presented at the Third Meeting of the Competition Law Forum, BIICL, London on September 10, 2003. The authors thank their colleagues Matteo Bay, John Colahan, Tad Lipsky and Omar Shah for their comments.

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This article considers the appropriate test for exclusionary abuse under Art.82 in light of these cases. Since the cases do not consider the policy rationale for the rules in any detail, our discussion focuses on a paper published on the Commission’s website by a prominent official in DG Competition in the middle of 2003 that explores the application of Art.82 to rebate schemes by dominant firms.⁴ The Paper sets out the best description and defence for the position taken by the Commission in these cases and endorsed by the CFI. The Paper does not simply address legal technicalities regarding the application of Art.82 to rebate schemes. It raises fundamental questions about the nature of exclusionary abuse under Art.82. It sets out an analytical structure and a legal test that are applicable not just to rebate schemes, and not just to pricing, but to any abuse based on horizontal effects.

In the first part of this article we summarise briefly the conclusions of the CFI in *British Airways* and *Michelin II*. The second part of this article sets out our summary of the principal points in the Paper. In the third part, we address issues raised by the Paper’s discussion of the case law on rebate schemes. In particular, we discuss the need to read the judgments of the Court of Justice setting out the rules regarding rebates in the context of the German Ordoliberal school of antitrust thinking. In the final part, we explore the two main questions raised by the Paper: (i) the degree to which the Commission needs to show “foreclosure”; and (ii) the nature of the business justification defence, and consider how the answers to those questions relates to the concept of exclusionary abuse. In doing so, we set out our own outline of how to structure an abuse test based on sound economic principles.

I. The Recent Cases

The two recent cases—*Michelin II* and *British Airways*⁵—both concerned Commission decisions condemning price discount schemes by dominant firms. In both cases one of the central arguments of the applicant was that the Commission had not shown that the schemes had produced or would produce any harmful

4 Gyselen, “Rebates, Competition on the Merits or Exclusionary Practice?” to be published in *European Competition Law Annual 2003: What is Abuse of a Dominant Position* (Hart Publishing) (the “Paper”). The Paper was originally presented at the European University Institute, 8th EU Competition Law and Policy Workshop in June 2003.

5 Respectively, Case T-203/01 *Michelin v Commission*, September 30, 2003 (not yet reported) and Case T-219/99 *British Airways v Commission*, December 17, 2003 (not yet reported).

effects. In both cases this argument (along with the appeal itself) was rejected, not on factual grounds, but on the ground that there was no legal requirement for the Commission to show the likelihood of actual anti-competitive effects.

In *British Airways* the CFI held that “for the purposes of establishing an infringement of Art.82 EC, 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 . . . tends to restrict competition, or in other words, that the conduct is capable of having, or likely to have, such an effect”.⁶ Elsewhere in the judgment the CFI held that all that was needed for infringement of Art.82 to be established was for the system to “tend to prevent customers obtaining supplies from rival producers”.⁷ The CFI further held that BA’s discount system did just that because: (a) the schemes were progressive, with increased commission rates “capable of rising exponentially from one reference period to another” and (b) the CFI did not believe BA’s five main competitors could be regarded as being in a position to grant similar advantages to travel agents, in view of the fact that BA sold a multiple of the tickets sold by all five of those competitors combined.⁸

In *Michelin II* the CFI specifically stated that under Art.82 there is no need to show anti-competitive effect. Instead the Court ruled that conduct can be abusive if it “tends to restrict competition or, in other words, that the conduct is capable of having that effect”.⁹ The *Michelin II* judgment justified this rule by reference to cases that (according to the Court) establish that it is sufficient under Art.82 to show that conduct has the object of restricting competition. Since in *Michelin II* the object of Michelin was to make dealers more loyal, this practice must, according to the Court, have been susceptible of restricting competition.¹⁰

Michelin II also addressed a second issue that is important to assessment of exclusionary abuse—the extent to which a dominant firm can assert an efficiency justification for conduct that is otherwise abusive. The

Court suggested that an efficiency defence would be available for volume rebates where a dominant firm could show that increased purchases by a dealer gave rise to economies of scale for the customer. The Court does not give extensive consideration to this point since Michelin had not provided detailed information regarding cost efficiencies linked to its rebate programme. There is at least a suggestion, however, that the Court considered that any benefits must be “transaction-specific”, *i.e.* that the grant of a specific discount must be linked to economies gained through sales to that individual customer, and any additional discounts must be linked to additional benefits.¹¹

Thus the CFI has set a threshold for exclusionary abuse that requires no actual harm, no likelihood of harm, but rather merely the *potential* for harm. This threshold focuses on the restriction on the customer, rather than the effect on the competitor. At the same time the Court in *Michelin II* has suggested a test for finding efficiency justifications that could be difficult to meet in practice. Aside from the rather conclusory language of object and effect in *Michelin II*, there is no attempt to explain the rationale for these rules in law or competition policy.

The reasoning that underpins this position has been elucidated very clearly, however, in the Paper by Luc Gyselen referred to in the introduction. Gyselen’s clear and intellectually coherent description of the “structuralist” approach to exclusionary abuse under Art.82 brings into the open the policy issues which underpin the rules set out in these CFI judgments.¹² Indeed, there are indications in the wording and analytical approach

11 *Michelin II*, cited above, paras [98]–[110]. The Court relied in particular on the judgment in Case C-163/99 *Portugal v Commission* [2001] E.C.R. I-2613, and the opinion of Advocate General Mischo in that case. *Portugal v Commission* involved, however, an infringement of Art.86 linked to discrimination under Art.82(c) in a case involving landing fees at airports—where the undertakings in question had a true monopoly due to legislative and infrastructure constraints. The facially non-discriminatory volume discount structure in that case had the actual effect of benefiting the major airlines established in Portugal, because they were the only airlines likely to meet the thresholds for higher volume discounts. The court in *Michelin II* does not even consider whether the transaction-specific approach used in that case is appropriate where the dominant firm is not an infrastructure-based monopoly, where there is not clear evidence of intent to benefit a class of customers from a particular Member State, and where the competitive harm (if any) is exclusion of competitors not exploitation of customers.

12 We note, for example, the comments of John Temple Lang and Robert O’Donoghue:

“[T]he Commission and the Community Courts have dealt with individual cases that were said to raise questions of abuse by reference to the facts of the individual case, seemingly without having any clear analytical or intellectual framework for doing so,” J.T. Lang and R. O’Donoghue, “Defining Legitimate Competition: How to Clarify Pricing Abuses Under Article 82 EC” 26 *Fordham Int. L. J.* 83.

6 *British Airways*, cited above, para.[293] (emphasis added).

7 *ibid.* para.[247].

8 *ibid.* paras [247], [272] and [276].

9 *Michelin II*, cited above, para.[239].

10 *Michelin II*, cited above, paras [241] and [244]. This analysis is, of course, correct to the extent that it is not necessary to show that a practice has already had a demonstrable anticompetitive effect in order to invoke Art.82. But in all the cases cited by the Court, with the exception of *Michelin I*, there was at least a plausible argument that real anti-competitive effects had either already occurred or were reasonably likely to occur if the conduct were allowed to continue. The *Michelin II* discussion does not explain why conduct that has the “object” of “possibly” restricting competition should be barred where it cannot be shown that such an effect is at least likely.

of the CFI judgments that suggest that the Gyselen paper may have had a direct influence on the approach taken by the Court. The test for abuse proposed in the Paper, like that set out subsequently by the CFI, would prohibit any conduct that has an appreciable *potential* for anti-competitive effect. In the specific context of rebate programmes, this would condemn any scheme that creates appreciable “switching costs” without regard for the programme’s actual effect on the market. We argue that this test is unduly interventionist and inconsistent with a competition policy based on sound economic principles.¹³

II. The Gyselen Analysis

The conceptual framework. The Paper starts by setting out a conceptual framework outlining a general approach to exclusionary abuse claims under Art.82. It then conducts a detailed analysis of each major Commission decision and Court judgment involving rebates from the 1975 judgment in the *Sugar cases*¹⁴ to the Commission decision in *Michelin II*.¹⁵ Finally, the Paper applies the principles that it has drawn from the analysis of the cases to reach “operational conclusions” for assessing future rebate cases.

The conceptual framework of the Paper is based on the premise that Art.82 is meant to protect competition as “a structural process of rivalry.” The Paper suggests that where pricing practices “artificially foreclose business opportunities” for the competitors of a dominant firm, those practices may “harm the competitive process.” The Paper suggests further that intervention by an antitrust enforcer to protect this process is justified because of a faith that the process of rivalry will contribute “*in the longer run*” to customer and consumer welfare. The Paper cautions, however, that the

relationship between the protection of rivalry and the eventual contribution to customer and consumer welfare “should have sound economic underpinnings” because otherwise the enforcer could end up protecting rivals, rather than protecting the process of rivalry¹⁶ and observes that controversy in concrete cases is likely to involve where to draw the line between protecting rivals and protecting rivalry.

The Paper considers rebate schemes in the context of Gyselen’s own two step approach for assessing exclusionary abuse claims under Art.82.¹⁷ The Paper argues that the first step in an abuse case should be to identify whether there is “foreclosure”. It does not define what is meant by foreclosure in this context, but the introductory comments suggest that the “question to be addressed (and clarified) is how [rebate] schemes influence the switching costs and artificially raise the barriers to entry for the dominant company’s competitors.”¹⁸ Where the Commission can make the requisite showing of foreclosure, the second step in the test would shift the burden to the dominant firm to show an efficiency justification for the conduct in question. This test would allow conduct that is justified on efficiency grounds, provided that the benefits were “proportionate” to the foreclosure effect.

The Paper identifies “two main questions to be addressed” in exclusionary pricing cases. The first involves the degree of foreclosure that the Commission must demonstrate to justify its intervention. The Paper concludes that the Commission needs to show an “appreciable potential foreclosure effect.”¹⁹ The second involves the efficiency justification—the Paper suggests that there is a question as to whether the dominant firm must show that the conduct is indispensable for achieving the claimed benefits. Since, however, no efficiency justification for rebate schemes has so far been accepted, the Paper focuses on the first question—when does a rebate scheme exert an “appreciable potential foreclosure effect”? To answer that question, the Paper reviews the case law on rebates.

The operational conclusions. The Paper divides the cases into three categories: (i) cases where rebates are paid in return for exclusivity (fidelity rebates); (ii) cases where rebates are paid if sales exceed a threshold set

13 This approach contrasts, for example, with the approach proposed in the recent study on switching costs prepared for the Department of Trade and Industry and the Office of Fair Trading in the United Kingdom:

“[S]uch non-linear discount schemes may have adverse effects for competition by making it much harder for competitors to win sales from the dominant firm. If the scheme is found to distort competition in this way, then intervention may be justified. However, such intervention should always be based on the actual economic effects of the scheme in question, rather than a *per se* prohibition based on its legal form.” N/E/R/A, *Switching Costs—Part One: Economic models and policy implications*, Economic Discussion Paper 5. OFT 655 (April 2003).

14 Case 40/73 *Suiker Unie v Commission* [1975] E.C.R. 1663; [1976] 1 C.M.L.R. 295.

15 [2002] O.J. L143/1; subsequently dismissed on appeal, Case T-203/01 September 30, 2003.

16 paras 9–10, emphasis added.

17 Gyselen first outlined this approach in a presentation at the Fordham International Antitrust Conference in 1989 (Gyselen, “Abuse of Monopoly Power” published in 1989 *Corporate Law Institute* (1992) and *EEC/US Competition and Trade Law* (1990) 597–650, hereinafter referred to as “Gyselen 1989”). We will revert at a later part of this article to the issues raised by the Paper’s proposed test for abuse.

18 para.3.

19 para.20.

individually for a specific customer (target rebates); and (iii) cases where rebates are paid in respect of sales exceeding general thresholds available to all customers (quantity rebates). The Paper draws the following conclusions²⁰ from its review of the case law:

- *Fidelity rebates—prohibited “per se”*. Where a dominant company grants a rebate in return for an exclusive purchasing commitment such a rebate is virtually prohibited *per se*.
- *Target rebates—the case law has involved assessment of entry barriers*. The Commission and the Community courts have in fact considered in each case whether a particular target rebate system raises entry barriers that are not “theoretical or entirely negligible.”²¹
- *Target rebates—the “loyalty-enhancing” nature of rebate schemes is based on “uncertainty.”* *Michelin I*²² is based on the “uncertainty” of dealers regarding the unit price for the product as the source for the loyalty enhancing effect of a target rebate system, which can have an equivalent effect to fidelity rebates.
- *Target rebates—even short reference periods can be abusive*. Because (according to the Paper) this “uncertainty” applies as soon as a rebate is calculated on the basis of more than one order, the Paper discounts the comment in *Michelin I* that target rebate schemes begin to tie dealers when they are linked to a relatively long reference period.²³ The idea that a three month reference period provides a safe harbour for any rebate scheme is rejected.²⁴ The Paper suggests that even a one month reference period could constitute a “relatively long reference period,” depending on the order cycle in the relevant industry.
- *Target rebates—assessment depends on length of reference period plus additional factors*. The Paper suggests that the legality of a target rebate scheme should depend on the following factors, in addition to the length of the reference period:
 - are rebates applicable on total volume during the reference period or only on incremental volume above the target?

20 paras 119–142.

21 paras 123–124.

22 Case 322/81 *NV Nederlandsche Banden-Industrie Michelin v Commission* [1983] E.C.R. 3461.

23 para.125, referring to [1983] E.C.R. 3461, para.[81].

24 The Paper notes that there were reference periods in Case T-228/97 *Irish Sugar Plc v Commission* [1999] E.C.R. II-2969; [1999] 5 C.M.L.R. 1300 and in *Virgin/British Airways* [2000] O.J. L30/1 (subsequently dismissed on appeal, Case T-219/99 December 17, 2003) of one week and one month respectively.

- are they applicable to a range of products (presumably in different product markets)?
- is the rebate scheme progressive (*i.e.* rewards increase with volume)?
- is the scheme transparent (*i.e.* customers do not know the precise targets or the rebate percentages applicable to meeting those targets)?
- are profit margins so low without the rebate that customers may be forced to reach the targets in order to achieve profitable sales?
- is the fidelity effect increased by the divergence in market shares between the dominant company and rival competitors or by the size of the dominant firm’s portfolio?
- *Target rebates—may also form part of wider anti-competitive scheme*. The Paper observes that even otherwise lawful rebate schemes may become abusive when “part of a broader web of fidelity enhancing arrangements.”
- *Target rebates—cannot be justified by scale economies*. The Paper concludes by noting that it is “genuinely ‘settled’” that target rebate systems cannot be justified on grounds of economies of scale.²⁵
- *Volume rebates—allowed where verifiable efficiencies can be shown*. Although non-individualised volume rebates can have the same fidelity enhancing effect as individualised target rebate schemes, Gyselen would allow such schemes provided that the payments can be justified by verifiable efficiencies for the seller.

III. The analysis of the case law

We do not dispute the broad outline of the traditional law on rebates under Art.82 as described in the Paper. We question, however, specific aspects of the analysis. Since these points have a bearing on the broader issue of how Art.82 should be applied to rebate systems in the future, we discuss them in detail below. We argue:

- The Paper is incorrect in attributing the “loyalty enhancing” effects of target rebates to “uncertainty” regarding the final unit price, leading it to misinterpret the “key paragraph” in *Michelin I*. The Court’s analysis is clearly based on the “suction effect”—a form of switching cost.

25 The Paper observes that the Courts and the Commission have rejected this justification because of the discriminatory nature of the schemes.

- The Paper is incorrect in reading *Hoffmann-La Roche*²⁶ as taking no view on the legality of standardised volume rebate schemes—the Court clearly indicated that such schemes are lawful.
- The Paper is incorrect in suggesting that the Commission and the Courts have conducted an economic assessment of “entry barriers” in their rebate cases.
- The Paper is incorrect in suggesting that economies of scale have been rejected as an “efficiency” justification for target rebate schemes.

The loyalty-enhancing effects of target rebate programmes—the role of “uncertainty.” In what the Paper characterises as the key paragraph of the *Michelin I* judgment, the Court observed that a target rebate system based on relatively long reference periods 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.”²⁷ The Paper comments:

As to the increasing pressure, the Court does not explain where it comes from. In our view, the (increasing) pressure is caused by (increasing) uncertainty. The uncertainty as to whether or not [buyers] will manage to buy enough to receive a particular rebate at the end of the reference period does not enable them to determine the average net purchase price for the purchased products before the end of that period. It is this uncertainty which will encourage them to purchase the dominant company’s products. Every purchase from a rival competitor during the reference period will increase the uncertainty and the pressure.²⁸

The Paper returns to this point in the conclusions:

The problem with this uncertainty is not only that it may put increased pressure upon the customer towards *the end* of the reference period, to purchase more from the dominant company . . . The problem—and the main problem—is that the uncertainty is there *throughout* the reference period. It is this uncertainty which “tends to remove or restrict the buyer’s freedom to choose his sources of supply [and] to bar competitors from access to the market”.²⁹

The identification of “uncertainty” as the key to fidelity is important, because it provides the basis for the Paper’s challenge to any rebate programme that goes beyond a typical order cycle. Analysis of the effects of a target

rebate programme demonstrates, however, that uncertainty as to whether the customer will reach the target is not the key in assessing the extent of a fidelity effect. The major issue, as economic literature suggests, is the presence of switching costs. Switching costs do increase over the reference period for a target rebate scheme and their size in relation to the initial price increases dramatically with the length of the period, creating what some German commentators have referred to as a “suction effect”.³⁰ Uncertainty is, at best, a secondary factor in assessing the extent of likely switching costs.³¹

This conclusion is consistent with *Michelin I*.³² The reference in para.[81] to “increasing pressure” at the end of a “relatively long reference period” and to the risk to the buyer of otherwise “suffering the loss for the entire period” is a clear reference to the suction effect, described above. This is confirmed by the Advocate General’s argument on the same point, where he specifically refers to “the suction effect of the periodic discount system.”³³ Furthermore, the reference to uncertainty at para.[83] in the Court’s analysis (as opposed to its summary of the Commission’s arguments at para.[78])

30 This may be illustrated with a simplified example. Suppose the dominant firm M sells heavy goods vehicle tyres to distributor D for a list price of €50 per tyre. D sold 4,000 tyres last year—2,500 of which were for M. M’s agreement with D specifies that D will receive an additional bonus of 1% if D reaches a calendar year target of 2,500. New entrant R, a major producer in Japan, has decided to enter the market. Assume for simplicity that the standard margins D would make on R’s tyres are the same as those on M’s tyres. Assume further that D believes he can sell 600 of R’s tyres over the year, but that if he does so he would fall short of M’s target (which he would otherwise make). What must R pay D in order to compensate D for “switching” part of its sales from M to R?

To make it worth his while to switch M would need to recover €1,250 (1% of D’s total sales at the list price (2,500 × €50)). But this will need to be spread over differing volumes of sales for R depending on the point during the year at which R seeks to persuade D to switch. If that point is January, R would need to offer the €1,250 from 600 sales, *i.e.* €2.1 per sale—a 4.2% discount per tyre. If, on the other hand R only persuades D to switch at the end of March, the number of tyres R can expect D to sell during the year is now 450. The €1,250 would therefore have to be earned from those sales, *i.e.* €2.8 per sale, a 5.6% discount per tyre. If R tries to persuade D to switch at the end of November the cost is spread over 50 tyres—€35 per tyre, a full 50% discount.

Clearly there will be all sorts of other factors at stake, but the example shows that the switching cost is low in the early months and prohibitively high towards the end of the reference period—a clear suction effect.

31 Where, however, the customer is certain that it will reach the target, regardless of its efforts for rivals, then the target scheme can have no loyalty enhancing effect whatsoever. This may be the case in the volume targets that major supermarket chains routinely agree with their suppliers—where the supermarkets place the target at a volume that they know they will achieve in the absence of extraordinary external circumstances.

32 [1983] E.C.R. 3461

33 Opinion of A.G. Verloren van Themaat, [1983] E.C.R. 3527, at 3542.

26 Case 85/76 *Hoffman-La Roche & Co AG v Commission* [1979] E.C.R. 461; [1979] 3 C.M.L.R. 211.

27 [1983] E.C.R. 3461; [1985] 1 C.M.L.R. 282 para.[81].

28 para.78.

29 para.129, citations omitted.

focuses on uncertainty as to “the effect of attaining their targets or failing to do so”. The Court is thus focused, albeit without extensive economic analysis, on the very significant switching costs that can arise in the course of an annual target rebate scheme towards the close of that annual period. The lack of transparency is viewed as increasing the effects of the scheme (which is consistent with our analysis.)

It is also necessary, however, to bear in mind the proximity to the beginning of the next reference period at the point at which switching costs become substantial. While the shape of the graph should not differ, clearly a reference period as short, for example, as three months would mean that the next reference period was just days or weeks away at that time. It is inconceivable that a rival would not be prepared to wait such a short period of time to compete. This explains the rule of thumb that target rebate schemes (or volume rebate schemes) with reference periods of three months or less are unlikely to have significant foreclosure effects unless they form part of a broader anti-competitive scheme or plan.³⁴

But what about the switching costs at the beginning of the period? Do they not have some “fidelity enhancing” effect? These costs are clearly very much lower but they could still constitute a barrier to a rival seeking to enter the market. The Court does not explicitly address this question, but the implication is that there is some level where the costs are low enough that they are not appreciable.³⁵

Target rebates and the ordoliberal tradition of Article 82. Our remaining comments have a common theme. The Paper’s assessment of the Court’s jurisprudence,

particularly the pivotal early cases of *Hoffmann-La Roche* and *Michelin I*, does not reflect the legal structure of abuse developed in those cases, a structure clearly based on German ordoliberal thinking. To follow the Court’s rulings in these cases, it is necessary to understand that legal structure and the policy considerations on which it was based.

Ordoliberal competition policy and EC Law. It is well established that the origin, development, and application of competition rules under the EEC Treaty was based on the policy and legal structure of German competition law.³⁶ The German delegation insisted on the incorporation of strong competition provisions in the Treaty. During the first two decades of the Community, German officials played the key role in developing and implementing competition rules and policy. Academic commentary and interest in the development of Community competition law was principally based in Germany.³⁷

German competition policy was based on the “ordoliberal” ideology developed by the “Freiburg School” of German academics and government officials before and immediately after the Second World War. The Freiburg School posited the need for an “economic constitution” that would set out the parameters for economic activity. This economic constitution would limit the emergence of private economic power by prohibiting cartels and other contracts that created unjustified limits on the competitive autonomy of firms. The economic constitution would also regulate the conduct of firms that had acquired economic power, by requiring them to act in a manner consistent with a competitive economic model. The goal of all these rules was not economic efficiency as such, although consumer benefits in terms of lower prices and better choice was regarded as a positive by-product of the system. The goal of the system was rather the limitation and control of private power in the

34 The Paper is of course correct to criticise the Commission decision in *Michelin II* for attributing this rule to explicit case law from the Court—as noted previously (see B. Sher, “Price Discounts and Michelin 2: What Goes Around Comes Around” [2002] E.C.L.R. 486) and as now recognised by the Court of First Instance (“CFI”) in *Michelin II* (para.[85]). It was, however, well-established Commission precedent, which was based on the approach to rebate schemes under German law. The Paper also argues that the one week reference period in *Irish Sugar* shows that the length of the reference period is not decisive. As we will note in our next section, however, the paragraph in that judgment cited in the Paper does not deal with foreclosure issues (which are the relevant issue for the reference period) but rather with whether the scheme in question qualified as a form of performance-based competition. The foreclosure in *Irish Sugar* resulted from the cumulative impact of a number of practices; the effect of a one week rebate, taken on its own, was not relied on by the Commission or the Court.

35 Most new entrants will expect to pay some switching costs to induce customers to try their products. Furthermore, where, as in our example, the new entrant is already established in another geographic market, its sales in the relevant market will be incremental sales on a marginal cost base, leaving substantial room for discounts in order to buy market share.

36 For a detailed discussion of the development of competition law in Germany based on ordoliberal views see D. Gerber, *Law and Competition in 20th Century Europe: Protecting Prometheus* (1998), p.266–333 (hereinafter referred to as “Gerber”).

37 As Professor Gerber writes:

“Germans were major supporters of the inclusion of competition law provisions in the Rome Treaty. The structures of the two main competition law provisions in the Rome Treaty (Arts 85 and 86) also closely tracked ordoliberal thought and bore little resemblance to anything to be found in other European competition laws at the time. While the prohibition of cartel agreements had analogues in US antitrust law, the concept of prohibiting abuse of a dominant position was an important new development that was particularly closely associated with ordoliberal and German competition law thought and very different from the discourse of US law” *id.* 264.

interest of a “free” and fair political and social order.³⁸

The goal of “fairness” played an important role in “ordoliberal” thinking.³⁹ The small and medium sized enterprises that formed the backbone of society in the ordoliberal view (and had been the engine for common economic recovery after the Second World War) required protection against unfair limitations on their commercial autonomy.⁴⁰ This meant that contractual limitations on commercial activity would be viewed with suspicion. Where dominant firms—firms that possess “economic power” in the ordoliberal sense—were concerned, fairness required that they refrain from conduct that limited the access of other market players to markets or sources of supply.⁴¹

Ordoliberal competition policy and “performance based competition”. In considering how an ordoliberal competition law would control behaviour of dominant firms, ordoliberal theorists adapted the existing legal concept of “*Leistungswettbewerb*”—competition on the basis of performance. This concept derived from nineteenth century rules on “unfair competition”. It described competitive conduct that could not be prohibited as unfair, even though it harmed competitors. On this basis, improvements in quality, reductions in price (as long as they were non-discriminatory and non-predatory), or improved after sales service, were classified as performance based forms of conduct. Where dominant firms used performance based methods of competition, it was thought that they should be free to

compete, even if their conduct harmed competitors. Significantly, early commentators identified fidelity rebates as a form of conduct that was specifically *not* performance based.⁴²

In the transition from theory to practice following the adoption of the German competition law in 1958, abuse of dominance issues were secondary until the 1970’s. By the mid-1970’s, however, a lively debate had developed on the appropriate test for conduct that “unduly hindered” the competitors of dominant firms. Professor Peter Ulmer of Heidelberg University proposed a two step approach for identifying abusive conduct: (1) the conduct must significantly affect the competition opportunities of rivals; and (2) the conduct must *not* be performance based competition.⁴³ In other words, classification as performance based conduct would provide a safe harbour, irrespective of effects on competitors. The Ulmer test was endorsed and applied in four judgments of the Berlin Court of Appeals between 1977 and 1980. Significantly two of these judgments involved rebate schemes.⁴⁴

Performance based competition in the Community Courts. When the European Court of Justice articulated its test for exclusionary abuse in *Hoffman-La Roche* and *Michelin I* it essentially adopted the approach advocated by Professor Ulmer. According to the Court, abuse consists of conduct:

- (1) that has the effect of reducing the competition in a market or preventing the emergence of new competition⁴⁵; *and*
- (2) where the effect is caused “by means other than normal competition on the basis of the performance of commercial operators”.⁴⁶

38 Gerber, cited above, p.244–251.

39 *ibid.* at p.241: “The market had to function in a way that all members of society perceived as fair and that provided equal opportunities for participation to all.”

40 It will be noted that this normative concept of autonomy also provided the basis for the formalistic approval of “restrictions of competition” under Art.85 (modern Art.81) in the early years of the Community. The autonomy norm has been rejected under Art.81, however, most notably in para.19 of the Commission’s *Guidelines on the applicability of Art.81 of the EC Treaty to horizontal co-operation agreements* [2001] O.J. C3/2 (hereinafter referred to as “Horizontal Guidelines”):

“Many horizontal co-operation agreements, however, do not have as their object a restriction of competition. Therefore an analysis of the effects of the agreement is necessary. For this analysis it is not sufficient that the agreement limits competition between the parties. It must also be likely to affect competition in the market to such an extent that negative market effects as to prices, output, innovation, or the variety or quality of goods or services can be expected.”

41 According to Werhard Möschel, Professor of Law at Tübingen University, “Ordoliberal does not rely on the process of self-healing of the overall society, but protects the individual’s economic freedom of action as a value in itself against any impairment of excessive market power.” Möschel, “Competition Policy from an Ordo Point of View” in *German Neo-Liberals and the Social Market Economy* (A. Peacock & H. Willgerodt ed., 1989), p. 147 (hereinafter referred to as “Möschel”).

42 Gerber, n.36 above, p.252–253.

43 See P. Ulmer, *Schranken zulässigen Wettbewerbs marktbeherrschender Unternehmen* (1977).

44 WuW/E OLG 1767 Kombinationstarif (KG 1977); WuW/E OLG 1983 Rama-Mädchen (KG 1978); WuW/E OLG 2148 Sonntag Aktuel I (KG 1979); WuW/E OLG 2403 Fertigfutter (KG 1980).

45 This effect must be in a market where competition has already been weakened by the presence of the dominant firm, *i.e.* the relevant market where dominance was found or a neighbouring market.

46 See *Michelin I* [1983] E.C.R. 3461, at para.[70]:

“As regards the application of Art.86 to a system of discounts conditional upon the attainment of sales targets, such as described above, it must be stated first of all that in prohibiting any abuse of a dominant position on the market in so far as it may affect trade between Member States Art.86 covers practices which are likely to affect the structure of a market where, as a direct result of the presence of the undertaking in question, competition has already been weakened and which, through recourse to methods different from those governing normal competition in products or services based on traders’ performance, have the effect of hindering the maintenance or

The significance of this passage has been obscured for many practitioners outside the German-speaking world by a translation error in the English version of *Hoffmann-La Roche*. The translators took the German word “Leistungen” via the French “*prestations*” to translate the key phrase as “normal” competition on the basis of the *transactions* of commercial operators. Although this error was corrected in *Michelin I*, a generation of non-German scholars and practitioners (and some Commission officials), have puzzled over the distinction between “normal” and “abnormal” competition. It is clear from the German and the French, and from the corrected version in *Michelin I*, however, that “normal competition on the basis of performance” is intended to be read as a single normative principle—equating to the German concept of *Leistungswettbewerb*.

Applying the performance based competition test—volume rebates. Under the performance competition test, as developed by Professor Ulmer and adopted in *Hoffmann-La Roche*, conduct that qualifies as “performance based” is immune from attack, regardless of its impact on competitors. A key issue in *Hoffmann-La Roche* was therefore whether the rebates in question could be characterised as a form of performance based competition. The Court ruled that the rebates in that case could not be regarded as performance based, because “they are not based on an economic *performance* which justifies this burden or benefit but are designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market.”⁴⁷ The Court then explicitly contrasted the *Hoffmann-La Roche* rebates with quantity rebates:

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.

The Court returned to this theme in para.[100], where it discusses the relevance of setting individual targets, which “appear at first sight to be of a quantitative nature as far as concerns their connexion with the granting of a rebate on aggregate purchases”. The Court rejects the suggestion, however, that this quantitative element was sufficient to bring these rebates under the performance based competition umbrella:

development of the level of competition still existing on the market.”

⁴⁷ *Hoffmann-La Roche* [1979] E.C.R. 461, at para.[90]. The word “transactions” in the English version has been changed to “performance”.

This method of calculating the rebates differs from the granting of quantitative rebates, linked solely to the volume of purchases from the producers concerned in that the rebates at issue are 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.

Thus the Court indicated as clearly as it could that a pure, non-discriminatory quantity rebate scheme was a form of performance based conduct that was not caught by Art.82. The Paper’s suggestion that this was “[a]nother issue naturally left open by *Roche*,”⁴⁸ and its subsequent argument that pure volume schemes should be subject to a demonstration of transaction related efficiencies, is flatly inconsistent with the Court’s assessment. The Court reached a similar conclusion in *Michelin I*⁴⁹ and the Court of First Instance made the same point in *Irish Sugar*.⁵⁰

Since the Paper was written, the Court of First Instance in *Michelin II* has lent support to the Commission’s approach to volume rebates. However, this has not been properly reconciled with the precedents of the Court of Justice.⁵¹

Performance based competition and efficiency defences. It is very tempting, particularly from a comparative law perspective, to link the Court’s application of the performance based competition test to a “business justification” defence as found in US law under the Sherman Act, s.2 or to an efficiency defence as applied under the EC Merger Regulation. Gyselen himself has linked the Court’s cases to these ideas both in this Paper and in his 1989 paper. The ordoliberal performance-competition concept is, however, quite different from

48 Para.42

49 It will be noted that the Court in *Michelin I* [1983] E.C.J. 3461 began its analysis of the target rebate schemes in para.[72] by establishing that the rebates in question could not be regarded as “performance based”:

“As regards the system at issue in this case, which is characterised by the use of sales targets, it must be observed that this system does not amount to 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 . . . ”

The strong implication, having regard for the fact that under the test for abuse already articulated in *Michelin I* it was necessary to establish whether the system involved performance based competition, is that “a mere quantity discount” rebate scheme would be performance based.

50 [1999] E.C.R. II-2969, at para.[213].

51 See discussion at the end of this Part.

either efficiency or business justification.⁵² As already noted, performance based competition is a normative concept—it defines a class of activities that are “what competitive firms do.” Thus while a volume discount that increases incremental sales will normally be associated with some economy of scale, whether a specific volume discount can be associated with a saving is not relevant. Furthermore and more important, measures that increase a firm’s efficiency and create definite consumer welfare benefits do not necessarily constitute performance based competition if they cannot be linked to the firm’s performance—*i.e.* lower prices, better service, better quality. Thus while it may be “genuinely settled”⁵³ that a target rebate system cannot be justified by economies of scale, all that means is that economies of scale do not make the scheme into a form of performance based competition. Furthermore it should not be surprising that there have been so few cases involving efficiency arguments, because the traditional interpretation of Art.82 does not allow for them.

Ordoliberal abuse control and foreclosure. Our final point concerning the Paper’s treatment of the traditional case law involves the second prong of the *Hoffmann-La Roche* abuse test—the requirement that abuse “reduce the amount of competition remaining in the market or prevent the emergence of new competition.” Here again from a comparative law perspective it is very tempting to equate this concept with the concept of “foreclosure” or “anti-competitive effects”, as indeed Gyselen did in his 1989 paper.⁵⁴ The problem with this comparison is that the ordoliberal ideal of keeping markets “open” meant that almost any potential disadvantage for a new entrant could be regarded as preventing the emergence of new competition. As a result, neither the Court nor the Commission has needed to engage in a serious investigation of foreclosure effects. A good example is *Michelin I*, where the Advocate General did not consider “an exact qualification of the aforesaid effects of the sales targets crucial in the last resort, since the Court

has already stated . . . ‘where the structure of competition has already been weakened . . . any further weakening of the structure of competition may constitute an abuse of a dominant position’ ”.⁵⁵

This is particularly evident in the rebate cases. The only issue that has been considered has been the extent to which there is a significant impairment of the freedom of customers to choose their suppliers. In none of these cases is there an attempt to consider the significance of the alleged barrier to entry for rivals in a market context.⁵⁶ The cases do not assess who likely rivals might be and how the need to pay switching costs would affect their cost structure. In none of these cases is there a consideration of the number of outlets foreclosed by the practices or of the alternatives available to rivals seeking to enter the market. Thus the Paper is not accurate in suggesting that the decisive question in these cases has been “in which circumstances will a particular target rebate system artificially raise entry barriers for the dominant company’s competitors.” Neither the Commission nor the Court has needed to consider rebates as a foreclosure problem as that term would be understood by an economist.

Subsequent CFI cases. This brings us back to the CFI judgments adopted subsequent to the Paper. In line with the approach articulated in the Paper, the focus in these cases is on the *form* of the rebates and its restrictive effect on the intermediaries, the effect on competitors being *presumed* from these qualities⁵⁷ (and, in *British Airways*, from the structure of the market). But why have these particular cases brought this issue of effects

55 [1983] E.C.R. 3527, at p.3543, quoting *Hoffmann-La Roche* [1979] E.C.R. 461, at para.[123]. Of course the Court articulated this test at a time when the prevailing rule under Art.85 (modern Art.81) was that a vertical agreement involving 5% of the relevant market or firms with turnover exceeding 100 million ECU would have an appreciable restrictive effect on competitors. Both Art.81 and Art.82 were thus based on a formalistic ordoliberal view of competition regulation.

56 The only exception to this statement would be *Virgin/British Airways* [2000] O.J. L30/1, but even there the Commission analysis is abstract and conclusory. (After briefly noting the significance of travel agents for airlines (para.[103]) the Commission concludes that “[i]t can only be assumed that competitors would have had more success in the absence of these abusive schemes” (para.[107]); yet we are not told the basis for such an assumption nor which facts support it). The CFI analysis is no more developed (see discussion at the outset of this article).

57 Perhaps the best example of a formalistic objection in both rebate cases relates to the retroactive (or “back to zero”) characteristic of the schemes in question. In *British Airways* this takes the form of a suggestion that just after the sales growth target is reached additional sales are likely to be made at a loss. This rather narrow focus on the mathematical implications of such a scheme at one particular point along the scale is cited as “particular” support for the proposition that BA’s only interest in its schemes must be to “oust . . . rival airlines” (see paras [288] and [289]).

52 The distinction between the ordoliberal system and one based on efficiency or contribution to consumer welfare was recognised by Professor Möschel:

“Modern currents in the American antitrust law which lean directly upon wealth maximisation, in Richard Posner’s constrained utilitarianism or Oliver Williamson’s trade-off and transaction cost approach as well as property rights doctrines as far as these can be traced to the Kaldor-Hicks criterion are obviously incompatible with the ordoliberal system of values. Ordoliberalism treats individuals as ends in themselves and not as a means of another’s welfare.” Möschel, n.41 above, at p.149.

53 The Paper, at para.136.

54 Gyselen used the word “foreclosure” as a shorthand expression for describing anti-competitive effects.

to the surface? The answer lies in certain particular features in each of the two cases. *Michelin II* is the first case in which pure standardised volume rebates have been condemned. In previous cases the exclusionary effects of the schemes could be blurred with the discriminatory effects, and the absence of an effects based analysis could be concealed amongst the language of discrimination and lack of objective justification. In *Michelin II* it was necessary for the CFI to “decouple” discrimination from exclusion and face, however reluctantly,⁵⁸ the logical consequences of the structuralist approach.

In *British Airways*, the applicant had pleaded the fact that the period of operation of the rebates coincided with one of steady *expansion* for Virgin Atlantic (far from any prospect of excluding them) and the US courts had reached a conclusion in the same case diametrically opposite to that reached by the European Commission.

Before we move on to consider an alternative approach to rebates under Art.82 we should note that the CFI has not been wholly internally consistent. A third CFI judgment, *Van den Bergh Foods*, strongly implies a rather different role for foreclosure effect under Art.82. We merely note here that the ability of the Courts to reach rather different conclusions when problems are *presented* differently illustrates the fragility of the structuralist approach.⁵⁹

58 One of the factors that has obscured this area for so long is that the case law is frequently presented so as to suggest it is doing something different to what it is actually doing. That is pre-eminently the case with volume rebates. The CFI judgment in *Michelin II* is framed to say quantity rebates are “generally considered not to have the foreclosure effect prohibited by Article 82” (para.[58]). Read in context, the Court is in fact saying that even quantity rebates are illegal unless they can be justified by economies of scale. The confusion is achieved by the adoption of an opening assumption that the quantity rebates are cost justified—adding as an afterthought that if they are not cost justified then they are not permitted. In reality discounts are not typically calculated according to economies of scale. They are rather, as the early Court case law recognised, a method of competing, and are therefore set according to competitive conditions in the market. Quite apart from the inconsistency of the CFI’s position with the early case law, this allows the Commission and now the CFI to create the appearance of reasonableness in what is in fact quite an extreme position.

59 The CFI in *Van den Bergh Foods* upheld the Commission’s finding that Unilever’s contracts to supply Irish retail outlets with freezers free on loan in return for brand exclusivity within the freezer infringed Arts 81 and 82 in the Irish market for impulse ice cream. A central issue in the case was the extent to which freezer exclusivity amounted in practice to *outlet* exclusivity. The CFI upheld the Commission’s assessment of 40% *de facto* exclusivity and in doing so in context of the Art.82 assessment as well as the Art.81 assessment it strongly implied that some degree of substantial *de facto* foreclosure was a necessary prerequisite for the finding of abuse. (Unilever had argued that only 6 per cent of the market was foreclosed). Case T-65/98 *Van*

IV. Foreclosure effects and business justification—an economic approach to rebates under Article 82

In this section we address the two main questions identified in the Paper—the standard for proving foreclosure and the standard for proving efficiency justifications. As the discussion in the previous section suggests, we do not think that the case law, which is imbued with the ordoliberal tradition, provides useful guidance on how these issues *should* be addressed in a competition law system based on sound economics. We therefore consider the analysis from a broader policy perspective.⁶⁰

Assessing “foreclosure” under Article 82

The first of the “main questions” identified in the Paper is “what level of foreclosure the Commission must demonstrate to justify its intervention” under Art.82?⁶¹ “Foreclosure” is a tricky concept,⁶² but the Paper is clearly correct in suggesting that an abuse test requires

den Bergh Foods v Commission, October 23, 2003 (not yet reported), para.[160]; currently on appeal Case C-552/03.

60 We recognise that the Paper itself is intended to state the current law. We also realise that as a Commission official (albeit one writing in a personal capacity) Gyselen is not in a position to attack well-established precedents, particularly where cases are currently under review in the Community courts. Nonetheless the Paper’s forthright defence of these precedents and its attempt to assert an economically sound basis for them warrants examination of the policy basis for the rules that the Paper identifies.

61 para.11.

62 Although the terms “foreclosure” and “foreclosure effects” are commonly used in competition law, they do not have a technical defined meaning. “Foreclosure” is often used colloquially to refer to any circumstances that prevent a seller from selling to a potential buyer or group of buyers. Foreclosure in this sense can result from a contract, from an acquisition, or from a course of dealing that leads a buyer to prefer products from another supplier. Gyselen uses the concept in this sense in his paper when he describes the negative effects of predatory pricing: “they may artificially foreclose business opportunities for the dominant company’s competitors”, para.9. “Foreclosure” is also often used, however, as shorthand for a “foreclosure effect”. A “foreclosure effect”, for its part, may simply describe the extent of simple foreclosure, *i.e.* if foreclosure applies to 5% of customers there is a “foreclosure effect” of 5%. “Foreclosure effect” may also, however, describe the effect on market structure of foreclosure—foreclosure of 40% of customers could lead to a change in market share for the favoured seller and create a substantial barrier to entry for disfavoured sellers. “Foreclosure effects” may further be used to describe the effect on consumer welfare of foreclosure—a rise in prices or a reduction in consumer choice. Finally “foreclosure effects” may define the entire range of anti-competitive effects that arise from exclusionary behaviour—including the effects of predatory pricing or strategic behaviour that does not involve foreclosure of specific customers.

some measure of actual or potential competitive harm that can loosely be described as a “foreclosure effect” in the context of exclusionary conduct.⁶³ The test proposed in the Paper, however, would prohibit any conduct that *could* lead to long-term competitive harm on a theoretical basis, without regard for the likelihood of such effects in the markets under investigation.⁶⁴ We set out below in more detail our assessment of the problems with the possible harm test and identify an alternative approach that could fit better with an economics based approach to Art.82. We start, however, with an excursion into the domain of comparative law, which provides useful insights into the issues that must be addressed under Art.82.

Exclusive dealing, exclusionary pricing and foreclosure in US antitrust law. At the beginning of the Paper, Gyselen observes:

[T]he area of discounting practices offers an interesting comparative law perspective. It is indeed in this area that the EC Commission has adopted most of its prohibition decisions and has followed pretty much a *per se* approach in doing so whereas in the US antitrust agencies do not seem to have deployed any public enforcement activity at all and federal courts assess private suits under an all-in-all deferential *rule of reason* approach.⁶⁵

The Paper does not, however, discuss *why* the position in the United States is so different. The reason is that US antitrust law takes a strict view on the need to show anti-competitive harm from allegedly exclusionary pricing practices.

The starting point for a comparative assessment is the law of exclusive dealing.⁶⁶ Until 10 years ago, analysis of exclusive dealing arrangements under US law involved assessment of two factors: (i) the percentage of the market subject to foreclosure as a result of the exclusive dealing arrangements; and (ii) the duration of

those arrangements. The general rule had allowed exclusive dealing arrangements with aggregate foreclosure of 35 to 40 per cent. There was also a general presumption that agreements with a duration of one year or less would not have significant anti-competitive effects, since rivals could bid for the business of those customers once the contracts expired. There has been a shift more recently, however, to a direct focus on consumer harm.

The leading case in the new wave of exclusive dealing cases is *Omega Environmental Inc v Gilbarco*.⁶⁷ The defendant in that case held 55 per cent of the market for retail gasoline dispensers and had entered into exclusive arrangements covering 38 per cent of all outlets in the market. The Ninth Circuit Court of Appeals reversed a judgment for the plaintiff, observing that alternative means of distribution (such as direct sales or distribution through service contractors) existed that were sufficient to eliminate any foreclosure effect and that the arrangements were short-term and easily terminated. Most important, however, the court emphasised that the plaintiffs had not shown that the agreements had deterred new entry, facilitated collusion, or by any other means had allowed the defendant to increase prices. The evidence suggested instead, according to the court, that output had increased and prices had gone down.

In a number of subsequent cases US courts have focused on the likelihood of anti-competitive effects in assessing exclusive dealing arrangements.⁶⁸ The shift to a direct assessment of anti-competitive effects has led to a down-grading in the importance of foreclosure percentages—a high percentage of foreclosed outlets may not give rise to competitive harm, while it may be possible to find consumer harm where there is no direct “foreclosure” at all. The duration of exclusivity arrangements remains relevant, but the focus is now on the practical ability of customers to terminate and switch rather than on the formal contractual ability to do so. In each case where a court has upheld an antitrust claim, there has been evidence of real market power on the part of the party imposing the exclusivity requirement.

63 Gyselen used the term foreclosure in this sense in his 1989 article where he addressed the cases under three headings: “(1) the nature of the exclusionary conduct; (2) the perceived foreclosure effect of the conduct (foreclosure being used here as a shortcut for anticompetitive effect generally); and (3) the objective justification for such conduct.” Gyselen (1989), n.17 above, at 617.

64 For this reason, we will refer to it below as the “possible harm test”.

65 para.2, citations omitted. The Paper concludes, “No wonder several commentators perceive the EC Commission’s policy in this area as a controversial one.”

66 See generally Jacobson, “Exclusive Dealing, ‘Foreclosure’, and Consumer Harm” (2002) 70 Antitrust L.J. 311. The precedents discussed involve application of both ss.1 and 2 of the Sherman Act and s.3 of the Clayton Act. Section 3 Clayton Act is particularly important for a comparative law assessment in this context because it specifically covers exclusive dealing contracts. Many of the non-s.2 cases involve sellers with a market share that would make them presumptively dominant under Art.82.

67 127 F.2d 1157 (9th Cir.1997). It will be noted that the market share would create a presumption that the defendant held a dominant position were Art.82 applicable.

68 *CDC Techs, Inc v IDEXX Labs, Inc*, 186 F.3d 74 (2d Cir. 1999) (exclusive obligations imposed on intermediary less significant than obligations on end-users); *Western Parcel Express v United Parcel Service*, 190 F.3d 974 (9th Cir. 1999); *Minnesota Mining & Mfg. Co v Appleton Papers, Inc*, 35 F. Supp. 2d 1138 (D. Minn. 1999) (realistic ability to switch is key); *Bepco, Inc v Allied-Signal, Inc*, 106 F. Supp. 2d 814 (M.D.N.C. 2000); *United States v Dentsply, Inc* 2000–1 Trade Cas. (CCH) ¶73,247 (D. Del. 2001); *United States v Microsoft*, 253 F.3d 34 (D.C. Cir. 2000); *cert. denied*, 122 S. Ct. 350 (2001).

In light of the strict standards for finding an antitrust violation where there are long-term exclusive dealing obligations, it is not surprising that few cases have emerged that involve discounting where there is not a *de facto* exclusivity or near-exclusivity requirement.⁶⁹ By its nature, a non-exclusive scheme gives rivals some access to sales, even through outlets participating in the relevant discount scheme. These sales would impose a direct constraint on consumer pricing and product quality for the firm operating the scheme. Furthermore, it would be very unusual to operate a rebate scheme with a duration of more than a year, so that the short effective duration would indicate a lack of competitive harm under US law, unless it were clear that switching at the end of the period was not a practical alternative for customers.⁷⁰

69 In *Concord Boat Corp v Brunswick Corp*, 207 F.3d 1039 (8th Cir. 2000), the Court of Appeals reversed a judgment against the leading manufacturer of inboard and outboard marine motors for pleasure craft with a fluctuating market share of 50–75% (*i.e.* dominance in EU terms). The court concluded on the facts that the bonus programme (which involved discounts for commitments by customers to purchase an agreed percentage of requirements from the Brunswick for up to three years, in addition to volume discounts) did not confer or enhance any ability to charge supra-competitive prices. In *Avery Dennison Corp v ACCO Brands, Inc*, 2001–1 Trade Cas. (CCH) ¶72,882 (C.D. Cal 2000), in contrast, the court declined to grant summary judgment for the defendant where target discounts for some customers were combined with exclusivity agreements for others. In *LePage's Inc v 3M*, 324 F.3d 141 (Third Circuit 2003) (*en banc*), the Court of Appeals found that a rebate system for cellophane tape that was linked to purchases of unrelated office products (such as staplers) could be exclusionary where the seller had a market share in the tape market of nearly 90%.

70 In the 1998 edition of his treatise, Professor Hovenkamp makes the following comment on annual target rebate schemes:

“Note first that this arrangement cannot have greater anti-competitive effect than an outright exclusive dealing arrangement of one year's duration. Further, the competitive impact must be less because an equally efficient rival can take the customer by bidding a better price and even by compensating the customer for the loss of the discount from the defendant—assuming, as we have, that the defendant's program yields prices above cost at all discount levels. Further, if a rival cannot match the price, that is a strong indicator that the quantity discount program is efficient in the sense that the larger volume customer imposes lower per unit costs than does the smaller customer.

For these reasons we suggest that discounts attached merely to the quantity of goods purchased, and not to exclusivity itself, be treated as lawful and not subject to the laws of exclusive dealing.” H. Hovenkamp, *Antitrust Law* ¶1807c, at n. 16 (1998).

In his most recent supplement, Professor Hovenkamp has revised his views to take into account the recent ruling of the Court of Appeals in *LePage's*. He accepts in principle that a target rebate scheme covering products in different product markets can be exclusionary if it has the effect of excluding an equally efficient single-product rival. He would limit this principle, however, to situations where there is not significant uncertainty regarding market definition and where the seller has an extremely high market share (approaching 90 per cent) in the affected market.

We do not mean to suggest that the rules applicable to discounting schemes in the United States should be adopted as a matter of course under Art.82 without reflection. Where, however, substantial differences exist, the Commission should at the very least carefully consider whether there are good policy reasons for these differences. From this perspective, the substantial differences between the modern US law and its focus on the likelihood of consumer harm and the EC case law described in the Paper give rise to (at least) three questions. The first question is why the Commission and Member State competition authorities devote so much enforcement attention to non-exclusive discount cases when the US authorities regard them as unworthy of serious consideration? The second question is whether “switching costs” that by their nature are only applicable for a limited period can ever constitute a significant barrier to entry? The third and most fundamental question is why should Art.82 analysis focus on switching costs and barriers to entry, rather than focusing instead directly on likely harm to consumers? These questions should be kept in mind as we assess the implications of the possible harm test.

The possible harm test for foreclosure. The Paper identifies two scenarios in which the Commission could apply Art.82 to exclusionary pricing. The first involves “actual foreclosure”—the case where “there is empirical evidence that the dominant company's behaviour has actually produced foreclosure effects to the detriment of competitors.” The Paper provides an example of such effects by using a passage in the Commission's Guidelines on Vertical Restraints to suggest that “even a modest tied market share may already lead to significant anti-competitive effects” where the seller is dominant.⁷¹

He would also exclude its application where there is a rival capable of offering its own multi product scheme. See P. Areeda and H. Hovenkamp, *Antitrust Law* 2003 Supplement, ¶749, at 141.

71 [2000] O.J. L291/1 (hereinafter referred to as “Vertical Guidelines”), at para.148.

This passage, as quoted at para.18 of the Paper, concludes “the stronger the dominance, the stronger the risk of foreclosure of other competitors.” The Paper observes that this passage suggests that “the Commission will quickly conclude that there is a problem” (*i.e.* that even small foreclosed market shares may lead to concern) and that “it will apply Art.82 as soon as there is potential foreclosure” (referring to the statement that the conduct “may already lead to anti-competitive effects”).

The Paper's reliance on the Vertical Guidelines in this regard appears to be misplaced. As the Vertical Guidelines make clear (at para.3), they “must be applied in circumstances specific to each case” which “rules out a mechanical application.” Thus the use in the Vertical Guidelines of the language “may lead to concern” or “may already lead to anti-competitive effects”, like the reference to a “risk of foreclosure”, all reflect the role of the Vertical Guidelines in assisting companies to make their own assessment of vertical agreements under Art.81. This language

The reliance on the Vertical Guidelines and Gyselen's own previously published views together suggest that "foreclosure" for these purposes is meant to be a surrogate for "anti-competitive effects".

The Paper does not need to dwell on the nature of foreclosure, however, because the principal concern is to establish that there is no need for the Commission to show actual foreclosure at all. Referring to the judgment of the Court of Justice in *AKZO*⁷² and the judgments of the Court of First Instance in *Compagnie Maritime Belge*⁷³ and *Irish Sugar*,⁷⁴ the Paper asserts that "while being a sufficient condition, actual foreclosure is not a necessary condition for application of Art.82."⁷⁵ According to the Paper, the minimum requirement is that "the dominant company's market behaviour is capable of producing appreciable foreclosure effects to the detriment of competitors". This test is rephrased in a subsequent passage as the need to prove "appreciable potential foreclosure effects".⁷⁶

On its face, the proposed test appears reasonable enough. It is clear that Art.82 should not be restricted to cases where anti-competitive harm has already occurred, so "potential" effects must also be caught. It is also welcome that the test would only apply where the effects identified are "appreciable". If "foreclosure effects" means anti-competitive harm, an "appreciable

potential foreclosure effect" could be read as indicating "a reasonably likely anti-competitive harm"—which could be an appropriate subject for competition policy concern. The problems with this approach emerge, however, when we see how it is applied in practice in the rebate cases.

The theoretical basis for applying the possible harm test in a rebate case, as we understand it, is based on the following propositions:

- Rebate schemes can create "loyalty-enhancing" effects.
- These loyalty enhancing effects *may* generate "foreclosure effects", for example:
 - a barrier to entry for rivals that wish to enter the market; or
 - limits on the ability of existing rivals to sell to customers participating in the schemes.
- Foreclosure of customers and deterrence of new entry *may* lead to significant anti-competitive effects.

Although the Paper acknowledges the need to assess allegedly abusive practices "in their market context," the lengthy discussion in the Paper of the "evidentiary exercise" needed to exclude a "theoretical or entirely negligible potential foreclosure problem" is devoted entirely to consideration of the "fidelity-enhancing" nature of a rebate system.⁷⁷ Thus in practice the assessment of the "market context" is limited to the first step in the analysis, whether the rebate scheme is "fidelity-enhancing".⁷⁸ The Paper does not consider it necessary to determine the percentage of the market "foreclosed" by the practices. The Paper also does not consider it necessary to assess whether the switching costs generated by the system are likely to create a substantial barrier to entry in the context of the specific affected

indicates circumstances where companies are on notice that an infringement of Art.81(1) is possible or even likely, but how "quickly" the Commission will conclude that Art.81 is applicable depends on the factual context of the actual case.

These passages in the Vertical Guidelines are also of limited support for the argument set out in the Paper because they only deal with one aspect of the pricing abuse discussed later in the Paper—fidelity rebates (*i.e.* rebates linked to total or near total exclusive purchasing). The Vertical Guidelines treat other pricing policies such as quantity rebate schemes as a form of "quantity-forcing" that has "similar but weaker foreclosure effects than a non-compete obligation". In contrast with the categorical treatment in the Vertical Guidelines of exclusive dealing by dominant firms ("[d]ominant firms may not impose non-compete obligations on their buyers unless they can objectively justify such commercial practice within the context of Art.82" (para.141)), the Vertical Guidelines state that the assessment of quantity-forcing measures "depend[s] on their effect on the market" (para.152) and, as regards Art.82, observe only that "English clauses" and "fidelity rebate schemes" are specifically prohibited. See also Vertical Guidelines para.119, point (4) ("The degree of foreclosure may therefore be less with quantity-forcing").

72 Case C-62/86 *AKZO Chemie BV v Commission* [1991] E.C.R. I-3359.

73 Joined Cases T 24-26/93 & 28/93 [1996] E.C.R. II-1201.

74 [1999] E.C.R. II-2969.

75 para.18. The Paper observes earlier on that proof of predatory intent, without a showing of unlawful conduct, is not sufficient to prove abuse, although it could be relevant in assessing the validity of *ex post* commercial justifications.

76 para.20. The focus on potential effects is perhaps similar to the CFI's subsequent focus on "tendency" to restrict competition and "capability" of having such an effect in *Michelin II* (see discussion at the end of Pt II, above).

77 See generally paras 123-134, in particular para.124 ("Lack of clarity is due to the fact that the Commission does not use a predictable checklist of parameters for assessing which rebates are fidelity enhancing"); para.130 ("the only way to undo a rebate scheme entirely of its fidelity enhancing effect is to unbundle the sales transactions during the given reference period and to require that rebates be solely linked to quantities which the customer has formally committed to purchase in separate sales transactions"); para.134 ("the objective market circumstances may further enhance the fidelity enhancing effects of the rebate systems"); para.135 ("In some of its decisions, the Commission also stresses the cumulative fidelity effect of several co-existing rebate schemes").

78 The approach to proving appreciable switching costs in the Paper is also fairly minimalist, in that it sees a potential "loyalty-enhancing" effect in any rebate scheme with reference periods that extend beyond a normal order cycle, although the Paper does recognise that the appreciability of this effect and thus the extent of switching costs may depend on other factors.

market. Finally, the Paper does not consider it necessary to investigate whether it is likely in practice that any foreclosure created by the system will lead to a significant anti-competitive effect. In short, once “appreciable” switching costs are shown, the “potential foreclosure effect” required under this test results from the *possibility* of significant barriers to entry/foreclosure followed by the *possibility* of a significant anti-competitive effect.

There are two possible explanations for this approach. The first is that there is in fact a strong causal link between a showing of appreciable “fidelity effects”, the creation of significant barriers to entry, and a likely loss to consumer welfare, and that this link exists in any market where there is a dominant firm, thus obviating the need for a market-specific assessment. We will explain later in this article why this presumption is unwarranted. The second explanation follows from the idea that Art.82 is meant to preserve the “structural process of rivalry.” The possible harm test is consistent with a structuralist approach to Art.82—one that focuses on changes in market structure rather than directly on conduct in the market or economic effects.

“Structuralism” and the “possible harm” approach to abuse under Article 82. Gyselen clearly sets out his view of the purpose of Art.82 in the first section of the Paper, where he contrasts the goal of intervention in exclusionary pricing cases with the rationale for intervention in excessive pricing cases:

The antitrust enforcer’s intervention in [exclusionary pricing] cases is—conceptually speaking—trickier than in the case of excessive pricing because it is inspired by a faith in the process of rivalry between competitors *and* in this process’ contribution to customer and consumer welfare in the longer run. This “faith” should not be of the religious kind, but should have sound economic underpinnings. If not, the enforcer might end up protecting one or more *competitors* in rivalry rather than the structural *process* of rivalry between them.⁷⁹

There are two important points here.⁸⁰ The first is the link to “customer and consumer welfare in the longer run.” The focus of Art.82 is seen as protecting a “process” that has long run benefits, not on preventing losses to consumer welfare in the short or medium term. The second point emerges from the concluding sentence,

⁷⁹ para.10.

⁸⁰ It is also notable that the Paper attributes this policy concern to “the antitrust enforcer”, implicitly including the US enforcement agencies. In light of the modern US focus on anti-competitive harm, we doubt that many US antitrust enforcers would endorse the proposition that the goal of policing exclusionary conduct is to protect the “structural process of rivalry” particularly if it meant focusing on structural change in the abstract.

which refers to “protecting . . . the structural *process* of rivalry.” The key word here is in fact not “process” but “structural”. For competition lawyers, “market structure” describes certain attributes of a market, including the number and size of market participants, the identity of potential entrants, the number of customers, access to supply inputs, the role and importance of intermediaries or, most important for present purposes, the presence of barriers to entry. In “pre-Chicago” antitrust economics, the supposed relationship between market structure, market conduct, and ultimately market performance was the central justification for intervention in both “dominance” and merger cases and a structural analysis remains the point of departure for assessing dominance under Art.82. Thus to protect the “structural process of rivalry” the implication is that the Commission needs to protect the market structure that facilitates that rivalry.

If the purpose of abuse control is to preserve a market structure that allows rivalry, then it is logical to prohibit any conduct that *could* have a detrimental effect on that market structure, unless it can be specifically justified. The Paper’s approach to rebate systems would catch any system that could potentially have an anti-competitive effect and thus would satisfy this objective. This was, of course, the ordoliberal perspective on abuse control and it is not surprising that the Art.82 case law, which is thoroughly grounded in ordoliberal ideology, is consistent with the strict structuralist test proposed in the Paper.

The consistency between **the possible harm test** and the Art.82 case law of the Community Courts cannot, however, be a sufficient reason for following this approach. The key question is whether, having jettisoned the formalistic ordoliberal approach to Art.81 in favour of economic analysis, a structuralist ordoliberal approach should be retained in Art.82? In answering that question it is important to understand that use of economic concepts like “switching costs” in a structuralist test does not turn that structuralist test into an economic analysis.

The central difficulty with the structuralist approach is that it involves a certain amount of “faith” not in the competitive process in general, but in the relationship of a change in the structure of the market to long-run consumer welfare. Although the Paper recognises that “this ‘faith’ should not be of the religious kind, but should have sound economic underpinnings,”⁸¹ the Paper does not discuss the nature of these “economic underpinnings” in any detail, either generally or in the specific context of rebate systems. In reality, however,

⁸¹ para.10.

there is no way to make the link between an effect on market structure and long-run consumer welfare without assessing the likely effects of conduct in the context of the specific market in question.

A pure structuralist analysis has three additional defects that follow from its lack of sound economic underpinnings. First, the structuralist approach will inevitably lead to “false positives”—cases that do not involve any harm to consumer welfare but that generate major transaction costs for firms under investigation and for competition authorities. Second, a structuralist approach, particularly one focused on barriers to entry, runs the risk of prohibiting conduct that can promote consumer welfare in the short or long term. Given the broad range of potential positive effects of discount systems, which we discuss later in this paper, we do not have faith in a defence based on business justifications as a filter for avoiding such effects, particularly if it is narrowly focused on transaction specific efficiencies. Finally, and most important, a structuralist approach will inevitably result in protecting competitors rather than competition in many cases. It provides an incentive for rivals to use the regulatory system as a competitive tool and fosters “me too” competition, while creating a disincentive for rivals to develop alternative ways of getting their products to consumers. For these reasons, we do not see how the possible harm test can be reconciled with a competition policy based on economic effects.

Of course, there is not necessarily a requirement in the Treaty that the test for abuse under Art.82 have “sound economic underpinnings.” It is possible to argue that the “right” of competitors to have access to the market *should* be protected.⁸² It is possible to *believe* that a competition policy that promotes open market structure as a goal in itself will in the long run often lead to positive economic results. Whether this approach is based on an ordoliberal world view, on post-ordo ideas of “fairness” for market players,⁸³ or on a perceived

need to protect the “legitimacy of the competitive process,” however, it is idle to pretend that it represents a competition policy grounded in modern economic theory.⁸⁴ If the Commission regards a non-economic approach to exclusionary abuse as appropriate, the Commission should clearly state the reasons for that approach and construct its enforcement policy accordingly.

Switching costs and anti-competitive effects—is a general prohibition of “loyalty enhancing” rebate schemes justified on economic grounds? As we have already noted, the test proposed in the Paper would leave unanswered a number of questions that would appear relevant to an enquiry regarding “foreclosure effects”. It is not considered necessary to determine the percentage of the market “foreclosed” by the practices. It is not considered necessary to assess whether the switching costs generated by the system are likely to create a substantial barrier to entry in the context of the specific affected market. Finally, it is not considered necessary to investigate whether it is likely in practice that any

appear to predominate. The best example of this is *Michelin II* [2002] O.J. L143/1 where the headings in the Commission decision repeatedly refer to the “unfairness” of Michelin’s conduct. This concern is, however, logically separate from concerns about exclusionary behaviour. In this we are entirely in accord with Gyselen, who remarked in his 1989 paper (commenting on Case 27/76 *United Brands v Commission* [1978] E.C.R. 207):

“Though the foreclosure rationale was prevalent, the Court also suggested that for a dominant firm to limit its dealers’ freedom of action was in itself abusive. In other words, the Court also seemed concerned with *fairness* towards the contract partners, a concern that has less to do with the preservation of competition than with the prohibition of ‘customer exploitation.’ This concept can be viewed as a transposition of the consumer exploitation rationale which is so manifestly present in the enforcement of Art.86 but with which it has conceptually little in common” Gyselen (1989), n. 17 above, at 615 (citation omitted).

Because the fairness concern is essentially separate from any “foreclosure” concern, we do not deal with it in the body of this paper. We would note, however, that if fairness to customers is a real goal for Art.82 enforcement, there is still a need to look at the interests of the customers in their market context. Is it really “fair” to Michelin’s dealers to bar Michelin from offering them target rebates, if the result will be a further shift of Michelin sales efforts to vertically integrated sales outlets, driving independent dealers out of business? Is it “fair” to travel agency chains to impose strict limits on the ability of their biggest airline customers to offer them incentive schemes, if it means that the airlines will shift promotional activities to channels that by-pass travel agents altogether (like telephone or internet bookings)? We should be wary of a policy based on “fairness” that runs a risk of “protecting” its beneficiaries out of business.

⁸⁴ The ordoliberal approach, which has been described in unfairly summary form earlier in this paper, is in some ways very attractive. It only makes sense, however, as the basis for a comprehensive system of competition rules (and rules in other areas as well). If ordoliberal competition policy is to be retained in Art.82, one must ask why was it abandoned in Art.81?

⁸² See E.M.Fox, “What is Harm to Competition” (2002) 70 *Antitrust L.J.* 371, at 395:

“The principle by which the European Court condemns exclusionary practices by dominant firms, unless justified, is often phrased as a dynamic one: the right of market actors to enjoy access to the market on the merits. It is a principle of freedom of non-dominant firms to trade without artificial obstacles constructed by dominant firms, and carries an assumption that preserving this freedom is important to the legitimacy of the competition process and is likely to inure to the benefit of all market players, competitors, and consumers.”

⁸³ We have already noted that “fairness” in the sense of protecting the “autonomy” and freedom of action of market players was an important concern in ordoliberal competition policy. This concern carried over to Art.82 and in many of the rebate cases concerns regarding “unfair” treatment of customers

foreclosure created by the system will lead to a significant anti-competitive effect. The questions that the Paper deems unnecessary to consider are important, because there is no economic basis for a presumption⁸⁵ that even substantial switching costs will always create a serious barrier to entry,⁸⁶ or that creation of a barrier to entry will by itself lead to a significant loss in consumer welfare.⁸⁷

Consider, for example, some factual issues that can affect the significance of switching costs as barriers to entry.⁸⁸ The first is the number and size of the customers participating in the programme and the proportion of

their sales that is shifted to the dominant firm as a result of the rebate scheme. Where the percentage of the market notionally “foreclosed” by the programme is relatively small, the effect of the programme in deterring market entry will also be small, even if the switching costs for those customers are high. The size of the “foreclosure” needed to create a significant barrier to entry will depend on a variety of factors, including the minimum efficient scale for entry and the minimum demand for the dominant firm’s product, in the absence of rebate programmes.

A second factor relevant to the significance of switching costs is the cost base of potential entrants. This may be illustrated by reference to *Michelin I*. In that case, the Commission notes in passing that the major potential entrants were manufacturers in the Far East. For these rivals exports to France were incremental sales—any contribution that these sales made to covering total cost increased profitability. Since manufacture of heavy goods vehicle tyres involves high fixed costs which domestic manufacturers in France need to recover in their pricing, the margin available to the Far Eastern exporters may be substantial, even after transport costs are taken into account. This might allow these producers to absorb even substantial switching costs without making sales in France unprofitable.

A third factor involves the duration and durability of the customer commitments that create a switching cost. A rebate scheme with an annual reference period may impose high switching costs on the customer at the end of that period, but those costs drop to zero at the beginning of the new period. A “barrier” that delays entry by an average of six months will normally not count as a major barrier to entry.⁸⁹ Where customers do not have a commercially viable option to terminate at the end of the reference period, however, the formal duration may be less significant.⁹⁰

Even if, in the context of a specific market, the fidelity

85 The Paper (at para.18) also compares, the distinction between potential foreclosure and actual foreclosure with the difference between restrictions that have the *object* or *effect* of restricting competition for purposes of Art.81(1). Although it does not elaborate on this comparison, it is worth noting that, according to the Commission, where contractual clauses have the object of restricting competition “they are presumed to have negative market effects” thus making an assessment of actual effects on the market unnecessary (See Horizontal Guidelines at para.18). This presumption is of course based on a generally held understanding of the impact of agreements that have as their principal purpose price-fixing, market sharing, or territorial division. The comparison of this potential foreclosure test with the “object test” under Art.81(1) is revealing, because it suggests that certain conduct should be presumed to have anti-competitive effects under Art.82, once certain prerequisites (*e.g.* the creation of switching costs) are met. This is also, as we have seen, the approach of the CFI in *Michelin II* where it was held (at para.[241]) that the concepts of “object” and “effect” were joined under Art.82. More recently, in discussing the Commission’s Art.82 review, Philip Lowe has suggested that “[i]n respect of certain types of abuses the *inherent potential effect* of the type of conduct concerned may be sufficient to find an abuse” (“DG Competition’s Review of the Policy on Abuse of Dominance”) Thirtieth Annual Conference on International Antitrust Law and Policy, October 23, 2003, Fordham Corporate Law Institute (emphasis added).

86 We refer here to “switching costs” because, as we have shown in Pt II, the Paper’s theory that loyalty effects are based on “uncertainty” is not correct. To find an economically viable support for the Paper’s legal test it is necessary to view rebate schemes as increasing “switching costs”.

87 We note that a substantial body of economic literature has developed that explores the possibility of welfare loss as a result of vertical foreclosure effects. See, *e.g.* P. Baake, U.Kamecke, H.-T. Normann, “Vertical Foreclosure versus Downstream Competition with Capital Precommitment” International Journal of Industrial Organisation, Abstracts of Accepted Papers (internet site) (July 2003) and papers cited therein. It is beyond the scope of this paper to consider the implications of this highly theoretical body of literature for EU competition policy. It appears, however, that the prevailing view rejects the “Chicago” conclusion that vertical integration is always efficient, but identifies harm to consumer welfare in a relatively narrow range of circumstances. This would underscore the need for caution in assuming a welfare loss due to “foreclosure” of competitive opportunities for rivals.

88 We provide these examples to show that a serious economic analysis is necessary to determine whether switching costs will constitute a significant barrier to entry and lead to anti-competitive effects. A full discussion of the criteria that would be relevant to that economic analysis is beyond the scope of this paper.

89 In the Vertical Guidelines (at para.126) the Commission suggests that “entry barriers can be said to be low” if effective entry is “likely to occur within one or two years.”

90 Relevant factors in this regard may include the residual demand for the product from specific customers and the buyer power of individual customers. Where individual customers must continue to stock some proportion of the dominant firm’s products (*i.e.* they cannot switch all purchases to the rival), their scope for switching at the beginning of a new period may be low—switching costs will be lower, but will not be non-existent. Some customers, however, will be able to impose a revised rebate scheme to facilitate a switch in purchasing patterns. Large supermarket chains in most EU countries, for example, have substantial leverage over the targets and other terms in rebate schemes. While supermarkets may not switch midway through a reference period, they will normally have no difficulty in switching part of their purchases to other sellers in the context of their next annual business plan.

effects of a rebate program do constitute a significant barrier to entry, it does not necessarily follow that these systems have anti-competitive effects.⁹¹ In this regard we do not dispute that there may usually be a relationship in markets where the dominant firm has genuine monopoly power—the ability to raise prices in a market above a competitive level. Dominance under Art.82, however, applies to firms that can act to an appreciable extent independently of competitors, customers, and ultimately consumers. While the ability of a firm to price above a competitive level clearly satisfies this test, it is not a prerequisite.⁹² The Community Courts have ruled that a firm with a market share over 50 per cent is presumptively dominant and the relative size of the allegedly dominant firm and its nearest rival is often regarded as a decisive criterion for assessing dominance.⁹³ On this basis, Art.82 has often been applied to firms that do not have true monopoly power in an economic sense.⁹⁴ Where Art.82 is applied to firms that do not have real monopoly power, there is no basis for presuming that current prices are above a competitive level or that any increase in “barriers to entry” will lead

to competitive harm in terms of higher prices or limitations on consumer choice.⁹⁵

An alternative approach for assessing exclusionary conduct. What is the alternative to the strict structuralist approach to abuse advocated in the Paper? In our view the central question should be whether conduct is *likely* to lead to anti-competitive effects (higher prices or reduced consumer choice) in the short to medium term. This would be consistent with the legal test applied under the Merger Regulation, where the Commission must show that a transaction will “in all likelihood” create or strengthen a dominant position “in the relatively near future”.⁹⁶ It would be consistent with the test for whether an agreement has the “effect” of restricting competition for purposes of Art.81(1): that it “be likely to affect competition in the market to such an extent that negative market effects as to prices, output, innovation, or the variety or quality of goods or services can be expected”.⁹⁷

It would also be closer to the test applied by the Community Courts in predatory pricing cases, where the Commission and Courts have found abuse only where there was evidence that competitors could be “eliminated”.⁹⁸

91 It is important in this regard to bear in mind that a change in relative market shares between the dominant firm and its competitors is not by itself indicative of an anti-competitive effect. It is an effect on competitors, but not necessarily on competition. This structural change is only significant in so far as it facilitates the exercise of market power.

92 Thus, for example, United Brands (as the seller of Chiquita bananas) was found dominant as a seller of bananas even though during the five years before the Commission decision it had been in a price war with its nearest competitor, Dole, leading to substantial losses for United Brands’ banana business. The Court ruled that “an undertaking’s economic strength is not measured by its profitability; a reduced profit margin or even losses for a time are not incompatible with a dominant position, just as large profits may be compatible with a situation where there is effective competition”, Case 27/76 *United Brands v Commission* [1978] E.C.R. 207, at para.[126]. Similarly Hoffmann-La Roche was found dominant in the market for selling vitamin C, even though pricing for vitamin C was clearly constrained by competing suppliers of antioxidant products, and even though prices for vitamins in general had declined over time in markets where there was substantial overcapacity, see Case 85/76 *Hoffmann-La Roche v Commission* [1979] E.C.R. 461, at paras [69]–[79].

93 In Case T-219/99 *British Airways v Commission* the CFI upheld a finding of dominance for a firm with a market share below 40% for the first time. Much emphasis was placed, in both the dominance and the abuse sections, on the fact that BA’s market share represented a multiple of the combined shares of its nearest five competitors (see especially paras [211], [224] and [276]). It could be argued that a rethinking of Art.82 on economic principles requires rethinking the test for dominance as well, but that goes beyond the scope of this paper.

94 We would be comfortable on this basis in accepting that an increase in barriers to entry would probably “entrench” the market position of a Microsoft or the West African shipping cartel; we are less comfortable with this assertion in the case of United Brands, Hoffmann-La Roche, or Michelin.

95 We would note that a number of the US cases where courts have rejected antitrust complaints regarding exclusive dealing claims because of a lack of market power have involved firms that would probably have been subject to Art.82.

96 See, e.g. para.[153] in Case T-5/02 *Tetra Laval BV v Commission* [2002] E.C.R.II-4381:

“Consequently, in a prospective analysis of the effects of a conglomerate-type merger transaction, if the Commission is able to conclude that a dominant position would, in all likelihood, be created or strengthened in the relatively near future and would lead to effective competition on the market being significantly impeded, it must prohibit it (see, in this regard, *Kali & Salz*, para.[221]; *Gencor v Commission*, para.[162]; and *Airtours v Commission*, para.[63]).”

Similarly the horizontal merger guidelines issued with the new Merger Regulation state:

“Effective competition brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation. Through its control of mergers, the Commission prevents mergers that would be *likely* to deprive customers of these benefits.” (para.8, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, January 28, 2004, not yet published, emphasis added).

Since the policy basis for controlling abuse is the same as that for controlling mergers that have unilateral effects, it would be logical that the requirements for the likelihood of harm be the same in both cases.

97 Horizontal Guidelines, at para.19.

98 Case C-333/94P *Tetra Pak v Commission* [1996] E.C.R. I-5951, at para.[44]. Although the rejection by the ECJ of a recoupment requirement in EU predatory pricing cases could be interpreted as indicating a “truncated” approach to proving consumer harm, it is important to note that in each predatory pricing case the Commission has conducted an analysis of the market leading to the conclusion that competition will be seriously affected. Thus in *Tetra Pak II*, the Commission found,

Assessing the likelihood of anti-competitive effects in a case involving rebates would require a three-step test.⁹⁹ The first step would be to consider whether the system does generate substantial switching costs.¹ We would suggest that a system with reference periods of three months or less is unlikely to create such costs, as long as the customer has a credible ability to switch to a rival supplier at the end of the period. The other factors identified by Gyselen² may be relevant in this assessment. Where rebates are offered to resellers, we would suggest that it is also necessary to consider the extent that the customer can influence the choices of final customers and the extent to which the reseller can meet the target by expanding its total sales.³

after detailed discussion of market conditions, including the actual effect of the practices on competitors, that the effect of the pricing practices was to “eliminate competition”, an analysis confirmed by the Court of First Instance in two paragraphs cited with approval by the Court of Justice (*Id.*, citing Case T-83/91 *Tetra Pak v Commission* [1994] E.C.R. II-755, at paras [151], [191].) See also, *ECS/AKZO* [1985] O.J. L374/1, at para.[86] (concluding after analysis of potential reaction from other competitors “that the elimination of ECS from the organic peroxides market would have had a substantial effect upon competition notwithstanding its still minor market share and the existence of other suppliers”); and *Deutsche Post AG* [2001] O.J. L125/27, at paras [36]–[37] (finding that below cost pricing where there is no prospect of price rise inhibited growth of more efficient rivals (para.[36]) with identifiable welfare loss (para.[37])). It is also worth noting the reasons given by the A.G. in *Tetra Pak II* for rejecting a recoupment requirement, *i.e.* since predatory pricing only makes sense where the dominant firm believes recoupment can occur, there is no need to go through the complex analysis of whether it will occur, [1996] E.C.R. I-5954, at 5983–84 (opinion of A.G. Ruiz-Jarabo Colomer). The CFI thus presents an incomplete picture in Case T-203/01 *Michelin II* when it cites *AKZO* for the proposition that pricing below variable cost is “*per se*” abusive for a dominant firm (see para.[242]). The economic harm identified in the predatory pricing cases goes far beyond some possible harm in the long-term.

99 In a case where a rebate programme is part of a broader anti-competitive scheme or plan, anti-competitive effects will be assessed on the basis of the effects of the plan as a whole.

1 Hewitt emphasises asymmetries (*e.g.* reputational advantage) and argues that harm to competition is more likely where too few firms are able to compete on roughly equal terms because competition centres on supplying customers’ (near) total requirements. That may be so, but there is no substitute in our view for analysis of actual switching costs in each case. Background note in *OECD Journal of Competition Law and Policy*—Vol. 5, No.2, 143, at 145 to 147 (hereinafter referred to as “Hewitt”).

2 At para.137.

3 Where an intermediary does not have a substantial ability to influence the choices of customers (*e.g.* where a wholesaler fills orders made by independent retail outlets), meeting rebate targets may depend on how well the wholesaler runs its business generally, but will not have any switching costs for rivals. A target rebate functions as a pure volume discount in this context.

One important factor that is ignored in the Paper, however, is the extent to which the buyer is capable of expanding its overall sales in order to meet the target. In effect, the model suggests that demand from the customer is static so that any inducement to purchase from one seller diminishes opportunities for other sellers. In fact where purchasers sell multiple products, they may

The second step would be to determine whether any substantial switching costs identified under step one do constitute significant barriers to entry or are likely to create substantial foreclosure (in the sense of reduced sales opportunities) for existing competitors. The factors identified in the previous section would be relevant to this assessment.

The third step would be to consider whether these barriers to entry or foreclosure effects are likely to lead to anti-competitive harm. It is crucial in this regard that anti-competitive harm cannot be equated with a change in relative market shares for the dominant firm and its rivals. The question must be whether the conduct is likely to lead to higher prices or a reduction in real consumer choice. This could be proven in two ways. One approach could be a “modified structural approach”. Under this approach, conduct that raised substantial barriers to entry in a specific market context could be presumptively abusive. This test, however, would only be justifiable where the dominant firm has real market power—not just “dominance”.⁴ Very high market share will usually be the indicator, but even high market shares should not justify finding abuse on the basis of a purely structural assessment where market definition is not robust.⁵

increase sales by switching promotional or sales resources from other unrelated product lines. The incentive may help sales for the dominant firm without directly injuring rivals. In this scenario the market share of the rivals may go down but there is no direct shift in sales opportunities between firms.

4 A truncated test for exclusionary abuse where a firm has a “super dominant” position would also be consistent with cases applying a higher standard of conduct under Art.82 to firms with a high market share. See Cases C 395/96 P & 396/96 P *Compagnie Maritimes Belge Transports v Commission*, [2000] E.C.R. I-1365; see generally R. Whish, *Competition Law* (5th ed. 2003), at pp.189–190. Nevertheless, caution should be exercised before invoking a truncated test. Muris warns that such a test “makes the most sense when the cost of proving actual consumer harm is high in individual cases and harm is strongly correlated with readily observable behaviour”. As Hewitt observes, the balance is unlikely to lie in favour of a truncated approach in all circumstances for rebates, given their pro-competitive effects. Muris, “Anti-competitive Effects in Monopolisation Cases: Reply” (2000) 67 *Antitrust L.J.* 693, at 701–702, quoted in Hewitt n.1 above, at 165.

5 In many cases where market definition is legally sufficient the relevant market does not capture all the competitive effects, making raw market share data less compelling as an indicator of real market power. This will particularly be the case for consumer goods where there are numerous partial substitutes and where purchasing decisions often involve choices between products that are not substitutes at all in a conventional sense. The recent merger decision in *Carnival Corporation/P&O Princess* (M.2706 C (2002) 2851, July 24, 2002), provides a good example. In other cases the geographic market definition may be legally sufficient but there will be close links with sales in a broader area, making market share in the “market” a less reliable indicator of market power. The definition of a national market in the two *Michelin* cases may provide an example of this.

In the **ordinary dominance** case, however, we see no alternative other than to examine the likely effects of a pricing system in the context of the affected market. A quick look at the two cases recently ruled upon by the Community Courts illustrates what this could mean in practice.

In *Virgin/British Airways*, the Commission ruled that the British Airways remuneration system for travel agents in the United Kingdom constituted an unlawful target rebate system, and the CFI upheld this decision. We may assume for the sake of argument that the BA system did have some loyalty enhancing effects. We may assume, again for the sake of argument, that without that system BA would have sold fewer tickets and its biggest UK-based rivals—British Midland and Virgin Atlantic—would have sold more tickets. The real issue, however, is whether it was ever likely that the impact of the system would affect the ability of BMI, Virgin, or other airlines to act as a competitive constraint on BA in the airline markets where they compete and thus lead to higher prices and a loss in consumer welfare. Intuitively we consider it doubtful whether the BA programme could have that effect.⁶ But the Commission never asked the question.

In *Michelin II*, the Commission found that the rebate system operated by Michelin had a fidelity enhancing effect on independent dealers for heavy goods vehicles tyres, and again the CFI upheld this decision. Even if we assume that there was a fidelity effect *and* that this fidelity effect had a substantial effect on the ability of rival tyre manufacturers to sell in France, the key question remains whether there was a likely impact on consumer welfare. On this point the evidence is ambiguous. There is a suggestion in the Commission's discussion of market definition that prices were higher in France than elsewhere in the Community (although this relates to Michelin's prices and not to average prices and the actual data is not provided in the published non-confidential version). **This could in turn suggest that control over independent distributors by Michelin had foreclosed lower price producers to an extent that allowed Michelin to raise overall prices.** We do not

6 It is noteworthy that the new competition that has emerged for British Airways since the Commission started its investigation—the low cost airlines, Ryanair, Easyjet, etc. do not rely at all on the travel agency distribution channel that the Commission opened up for them in the *Virgin/British Airways* decision. It is also noteworthy that the US courts rejected allegations against BA that were nearly identical to those relied on by the Commission and CFI, on the basis that there was no foreclosure effect of the practices, see *Virgin Atlantic Airways Ltd v British Airways plc*, 257 F.3d 256 (2d Cir.2001). See also the detailed comparison of the US and EU approach to the BA incentive agreements in Hewitt n.1 above, at 156–163.

know whether this was the case, however, because the Commission never asked the question.

We do not pretend that the economic analysis required to identify likely effects on consumer welfare will always be easy to conduct.⁷ We recognise that this kind of test will lead to fewer Art.82 pricing abuse cases by the Commission and national authorities and even fewer successful private actions. But cases like *Virgin/British Airways* (which formed part of a broader legal and commercial feud between the two British airlines) involve a lot of protection for competitors without much impact on consumer welfare. Only an abuse test with “sound economic underpinnings” can ensure that Community law protects the “competitive process” and not competitors.

Business justifications, efficiency defences and rebate systems under Article 82

The proposed test for business justification. The Paper identifies the second question that must be addressed in exclusionary pricing cases as “what type of efficiencies the dominant company can invoke as objective justification for whatever foreclosure its pricing practices may create”⁸ It is accepted in the Paper that “dominant companies are free to expand their market share at the expense of their competitors as long as they compete on the merits” and must “be given the chance to advance objective justifications for [their] behaviour”.⁹ The Paper equates such objective justifications with an “efficiency defence”. Acknowledging that “the case law does not provide much guidance”,¹⁰ the Paper concludes that standardised rebate systems (*i.e.* systems not based in individually-set targets) might be justified if the dominant company can “advance facts and figures to show that its conduct has led to verifiable efficiencies” in terms of economies of scale at the production level.¹¹ The Paper identifies an uncertainty, however, regarding whether it should be sufficient to show that efficiency-

7 This analysis is, however, well within the Commission's capabilities, as illustrated in *Deutsche Post AG* [2001] O.J. L125/27. In that case, the Commission cited the cases discussed in the Paper as establishing that fidelity rebates based on a percentage of requirements have an anti-competitive tying effect, “solely by reason of the method by which they are calculated” (para.[39]). Nonetheless the Commission *did* analyse the anti-competitive effect of the fidelity rebate system, concluding that the system prevented lower cost rivals from reaching the critical mass needed to operate efficiently (paras [37]–[38]). The Commission linked this effect to a consumer loss in higher prices and efficient use of scarce resources.

8 para.11.

9 para.21.

10 para.23.

11 paras 141–42. See now the discussion of benefits in *Michelin II*, paras [98]–[110], referred to at n.11 above.

based savings are proportionate to the size of the rebates, or whether the dominant firm should also show that there was no less restrictive means of generating these savings. The Paper observes that one issue “is genuinely settled”—“target rebate schemes cannot be justified on economies of scale grounds,” concluding “[i]t is in fact the discriminatory nature of these rebate systems which enables the Commission and Courts to reject out of hand the economies of scale justification.”¹²

Four preliminary comments are in order. First, it is not surprising that the case law gives little guidance on these issues. As we have explained above, the principle of “competition on the merits” or “performance-based competition” as developed in Germany and applied under Art.82 has never been driven by considerations of efficiency. Second, even within the confines of a narrow performance-based competition test, the Commission has always had the burden of proving that conduct was not performance-based.¹³ Third, while it may be genuinely settled that target rebates are not “performance-based competition” in the ordoliberal sense, it is not clear from the perspective of a competition policy based on economic effects why different treatment for similarly sized customers robs a rebate programme of an efficiency promoting effect.¹⁴ Finally, we are not sure why the relevant relationship to be proven is between the amount of the savings and the amount of the rebate—there is an argument that the proper balance is between the efficiency benefit and the competitive harm (we shall return to this point).

Economic benefits of rebate systems in the “real world”. In assessing the benefits of rebate schemes it may be an error to start, as the Paper does, by assessing whether the conduct has a “business justification”. The real issue must be whether the conduct generates welfare gains. While a contribution to the efficiency of the

dominant firm’s business will usually have such benefits, that is not the only way that a rebate scheme contributes to consumer welfare. The most direct and obvious benefit is that a rebate is a form of discount. This discount is a direct short-term consumer benefit unless there would be equal or greater discounts in the market if the rebate scheme in question is prohibited. This cannot be assumed, particularly in concentrated markets, where across-the-board discounts will be more transparent to rivals and readily matched. The fact that all rebate schemes involve a potential benefit in the form of lower prices means that prohibiting rebate schemes without proof of likely consumer harm from the scheme in question will itself lead to consumer harm in a significant percentage of cases.

Once the focus is placed on the business justification, a real problem with the Paper’s discussion is that it takes far too narrow a view of what constitutes a commercial justification. In part this deficiency reflects the fact that the ordoliberal model of Art.82 did not encourage parties to come forward with elaborate business justifications and even if parties did make such submissions they were not relevant to the Court’s judgments. In large part, however, it reflects a concept of “competition” and how markets work that is prevalent in the Commission and among some commentators on EU law, but that does not reflect commercial reality.

The Paper refers on several occasions to competition as a “process of rivalry” or, as Gyselen put it in his 1989 article, “competition as a *process* in which a multitude of competitors rival one another to court the consumer’s favour.”¹⁵ This focus on rivalry can put undue emphasis on the interaction between firms competing directly for specific orders from specific customers. Although this classical economic model may reflect competitive conditions for undifferentiated commodity products, it does not reflect the position in many markets in the “real world”. Firms, whether “dominant” or not, often spend far more time on product differentiation and on finding effective routes to market for their own products than on directly “competing” with a specific rival to win a specific order. “Competition” in such markets is the process by which a limit is imposed on the price at which a firm’s products can be sold, because otherwise customers will switch to substitutes. Often substitutes are imperfect—a substitute for one customer will not be a substitute for another and the same customer may regard different products as substitutes on different days or at different times. A focus on rivalry in such markets will tend to ignore the significance of conduct that

¹² para.136.

¹³ Thus in predatory pricing cases, the Commission has had the burden of showing that prices are below cost. See also Art.2 of Council Reg.1/2003 [2003] O.J. L1/1 (“In any national or Community proceedings for the application of Arts 81 and 82 of the Treaty, the burden of proving an infringement under . . . Art.82 shall rest on the party or the authority alleging the infringement”).

¹⁴ There may of course be issues of secondary line discrimination effects that would be caught by Art.82(c). The reform of Art.82 discrimination law in light of economic principles is outside the scope of this paper. We query, however, whether the major glass manufacturers who were the customers in *Soda Ash/Solvay* and *ICI* ([1991] O.J. L152/21 and L152/40) (decisions subsequently annulled on procedural grounds and readopted in proper form), or travel agency chains like American Express or Thomsons that were the possible objects of discrimination in *Virgin/British Airways*, require protection from secondary line injury of this kind.

¹⁵ Gyselen (1989), n. 17 above, at 600. Gyselen contrasted this concept of competition as rivalry with the perfect competition model.

contributes to consumer welfare by providing incentives for effective distribution.

A related problem is the assumption that in a competitive market, sellers will charge a uniform marginal cost-based price. In reality, of course, even in highly competitive markets price discrimination is endemic, particularly in the form of quantity discounts. These discounts do not necessarily reflect transaction-based efficiencies. They do reflect the fact that in almost any business with substantial fixed costs, any transaction that results in higher overall sales leads to lower costs per unit of production. Any incremental sale that covers marginal cost and contributes at all to fixed cost is profitable.¹⁶ The ordoliberal assumption that any discount that is made available on a discriminatory basis is not “competition on the merits” is theology—not economics.

The Paper does not challenge quantity discounts—discounts for “volumes which the customer has firmly committed to purchase in separate sales transactions.”¹⁷ Yet a contractually binding commitment to purchase a large volume of products can impose far greater switching costs on a customer and create higher potential barriers to entry for a rival than a target rebate scheme. At the same time, a target rebate scheme provides significant advantages to the customer because it reduces the risks to the customer of sales below expectations.¹⁸ On this basis, the implicit assumption that appears throughout the Paper—that rebate schemes create “artificial” barriers to entry, while contractually binding volume discounts are somehow “natural”, does not reflect commercial reality. A rebate scheme is a natural and “normal” commercial tool, that creates benefits for both buyers and sellers in most cases. As such, a rebate scheme should not be prohibited unless it

is likely to cause substantial anti-competitive harm. Standardised volume systems should be at least presumptively lawful, while target rebate systems should be at least capable of justification.

Examples of business justification for target rebate schemes. The Paper would limit “business justification” to pure volume rebate schemes and to proven economies of scale. Production economies are, however, only one reason for maintaining a rebate system. While it would be beyond the scope of this paper to assess such justifications in detail, two examples may be useful.

First, suppose that Michelin has a similar position in the market for car tyres to that it held in heavy goods vehicle tyres in *Michelin I* and that some tyres are sold by car dealerships, for whom tyre sales will never be more than 5 per cent of sales. In this scenario, a target rebate scheme could create an incentive for the dealer to put more effort into selling tyres, by advertising, by training employees, or by giving a specific employee direct responsibility for tyre sales. The primary effect of the target rebate is thus to incentivise the car dealer to sell more tyres than it otherwise would, not necessarily to switch sales by that dealer from a rival brand. Motivating intermediaries to sell more effectively will benefit Michelin and benefit consumers, at least in the absence of substantial foreclosure effects.

For a second scenario, suppose that British Airways enters into a contract with a travel agency chain under which the chain agrees to conduct specified promotional activities. These include prominent display of British Airways posters and literature and inclusion of the phrase “partner of British Airways” in the agent’s own promotional literature. Furthermore, wherever a customer requests flight options without specifying a preferred airline, the agent agrees that its personnel will include a British Airways option if that option is comparable to others in price and schedule. (This obligation is not exclusive, the agent can include as many additional options as it likes). The agent and British Airways both agree that, if these contractual commitments are met, the agent’s turnover in British Airways tickets will almost certainly exceed last year’s turnover by at least 5 per cent. British Airways could, of course, simply pay a flat fee to the agency for these services. The cost of monitoring compliance will, however, be high and monitoring activities may be intrusive for the agent. Under these circumstances, the target rebate provides an efficient and unintrusive tool for determining whether the agent has complied with its promotional commitments.

16 This point is made clearly in D. Ridyard, “Exclusionary Pricing and Price Discrimination Abuses Under Art.82—An Economic Analysis” [2002] E.C.L.R. 286, at 286–287.

17 para.130. The Commission has suggested on some occasions that *any* discount by a dominant firm must be justified by transaction-specific efficiencies. (e.g. see the Van Miert statement on the launch of the Coca-Cola investigation, DN: MEMO/99/42, July 22, 1999). Although the CFI’s judgment in Case T-203/01 *Michelin II* does not quite go this far, it suggests that volume discounts will frequently need to be cost-justified (see paras [58]–[75]). As Ridyard has shown, this could lead to significant welfare losses.

18 Suppose that the list price for a box of fruit from seller S is €10. Buyer A is offered a volume discount of 5% by S for committing to purchase 1,000 boxes (approximately one year’s sales). If A accepts the offer and only takes delivery on 800 boxes, A will have a loss €1,500. If, on the other hand, S agrees to give A a 5% discount *if* A orders 1,000 boxes, A loses nothing on any undershoot up to 950 and gains the possibility of reductions above that level.

Business justifications and foreclosure—what is the appropriate test for abuse under Article 82?

The Paper's discussion of business justification raises a final point of real importance—what is the relationship between a finding of competitive harm and a finding of commercial justification? This in turn raises further questions: Does abuse involve a proportionality test or a balancing test? Is “commercial justification” a safe harbour? How should the approach to proving “foreclosure” and to proving “commercial justification” affect the test for abuse as a whole?

This is a very topical question in US antitrust law today. The Court of Appeals in *Microsoft* has suggested that where there is a showing of significant anti-competitive harm and a showing of business justification, there must be a balancing test—the consumer welfare benefit of the practice must be compared to the anti-competitive harm.¹⁹ In effect, the *Microsoft* court would resolve monopolisation claims using an approach analogous to that applied in a rule of reason case under s.1 of the Sherman Act. The Department of Justice and the Federal Trade Commission, however, have filed a brief as *amicus curiae* urging the US Supreme Court to rule that conduct having a business justification cannot constitute monopolisation, regardless of its anti-competitive effects.²⁰ Significantly from a comparative law perspective, the agencies argue that conduct is business-justified if it would be profitable regardless of its exclusionary effects.

The Paper's test provides a safe harbour for conduct that meets its requirements for proving business justification. The Paper would require that, to qualify as business-justified the discounts offered in a rebate scheme be covered by cost savings. The Paper also suggests that the dominant firm may be required to show that the conduct is indispensable for proving the benefit. But each of these tests goes to the issue of whether there is a legitimate business justification. The Paper does not propose a comparison of the business justification with the competitive harm. The Paper thus treats the commercial justification, if proven, as a safe harbour. In doing so, it follows the ordoliberal approach

to performance based competition as a safe harbour, which was adopted in *Hoffmann-La Roche* and *Michelein I*.

It is at least arguable that a better test would be to compare the competitive harm resulting from the conduct with the commercial benefit in assessing abuse. Thus if there is only a limited “potential foreclosure effect”, a limited showing of commercial benefits would be sufficient.²¹ Where there are serious anti-competitive effects, it may be appropriate to require a showing of substantial benefits directly linked to the conduct that would exist irrespective of the exclusionary impact of the conduct, and even this showing may not be sufficient to justify some practices by real monopolists. This approach would be consistent with the approach taken under Art.81. It can only work, however, if the foreclosure investigation focuses on identifying anti-competitive harm that can be compared to pro-competitive benefits.

We acknowledge that there is no right answer to these questions. The challenge is to develop a policy that is coherent and that satisfies accepted policy objectives. In this context, there are clear relationships between policy choices. Thus if the threshold for “proving” foreclosure is low (as under the possible harm test) then, if we want to avoid “false positives”, it should be relatively easy to prove a business justification. If, on the other hand, we have a strict standard for foreclosure then it may be reasonable to put the burden on the dominant firm to show real efficiencies. If business justification is a safe harbour, it *should* be difficult to prove (at least if we require a showing of real competitive harm), while we could allow a wider range of business justifications if they are balanced against the level of competitive harm. The solution proposed by the Paper—a low threshold for anti-competitive harm coupled with a high standard for business justification is almost guaranteed to reach a wrong result in a significant percentage of cases, protecting rivals rather than rivalry.

Conclusion

We have sought to explain the roots of the Commission's potential harm approach to exclusionary abuse under Art.82, an approach now endorsed by the CFI. As long as the Commission, with the approval of the

¹⁹ *United States v Microsoft Corp*, 253 F.3d 34, 56–57 (D.C. Cir. 2001).

²⁰ Brief for the United States and the Federal Trade Commission as *amici curiae* supporting petitioner, *Verizon Communications Inc v Trinko*, (US Supreme Court, May 27, 2003). In their brief before the Supreme Court, the agencies restricted their submission on this issue to cases where a monopolisation claim is based on a refusal to assist a rival. In their previous brief in support of the petitioner's application for a writ of certiorari, however, the agencies suggested that this test was applicable to all claims of exclusionary conduct. The Supreme Court judgment did not reach this issue (US Supreme Court, No.02–682, January 13, 2004).

²¹ Since, as we have already pointed out, most rebate schemes have some commercial benefit, this filter would mean that most cases would fall outside Art.82, leaving only cases with serious anti-competitive effects.

Courts, adheres to such a structuralist approach to abuse under Art.82, the integrity of Art.82 as an instrument of competition policy based on economic principles will be in question. If the Commission decides to maintain the pure structuralist approach, it needs to articulate a clear basis for this policy that goes beyond reliance on a body of case law from the Community courts based on a very different tradition. In our view, however, it would be preferable for the Commission to revise its position on abuse and on Art.82 generally in

line with sound economic policy, as it has done with Art.81. This realignment of enforcement policy may deviate from the CFI's recent precedents. It is important to recall, however, that the CFI in those cases was endorsing a policy position proposed by the Commission. Such a realignment would in any event be justified because it would reflect an evolution in the understanding of the meaning of "undistorted competition"—the protection of which is the ultimate goal of Community competition rules.