



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

**DAF/COMP/WP3/WD(2008)48
For Official Use**

Working Party No. 3 on Co-operation and Enforcement

ROUNDTABLE ON BUNDLED AND LOYALTY DISCOUNTS AND REBATES

-- European Commission --

10 June 2008

The attached document is submitted by the European Commission to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 10 June 2008.

Please contact Ms. Sophie Blondieau if you have any questions regarding Working Party No. 3 [phone number: +33 1 45 24 15 02 - E-mail address: sophie.blondieau@oecd.org].

JT03245896

1. Statutory provisions, case law, decisional practice and/or guidelines

1. There are no statutory provisions dealing expressly with single product loyalty discounts or bundled discounts under EC competition law. Although not mentioned expressly in Article 82 of the EC Treaty that prohibits as incompatible with the common market in so far as it may affect trade between Member States any abuse by one or more undertakings of a dominant position, these practices can be caught by this Article, as shown by the decisional practice of the Commission and the extensive case law by the European Court of Justice and Court of First Instance (hereinafter “the European Courts”).

2. Discounts and rebates¹ are often used as instruments of healthy and legitimate price competition. For example, discounts based on the quantity, value, or volume purchased per single transaction are normally not exclusionary. Since dominant firms are not subject to effective competitive constraints, they should in principle be allowed and encouraged to share their profits by offering discounts and rebates, provided that this does not ultimately lead to depriving customers of the benefits of residual competition. Also the bundling of products in the case of multi-product rebates may allow the dominant undertaking to provide customers with better products and offerings in more cost effective ways.

3. The difficulty for the competition authority or other enforcer of the competition rules is, as with so many alleged abuses of market power, to distinguish such genuinely pro-competitive behaviour from anti-competitive or exploitative conduct. At one end of the spectrum, where the discount/rebate is a direct reflection of the dominant company’s efficiency, it will be unobjectionable. At the other end, where the only commercially rational explanation for the discount/rebate is in terms of an attempt to exclude competitors or exploit customers, it will infringe Article 82.

4. In *Hoffmann-La Roche*², the Court gave its most comprehensive indication that rebates can infringe Article 82. It said that a dominant firm may not only infringe Article 82 when it ties purchasers *de jure* through exclusivity obligations, but that “*the same applies if the said undertaking [the dominant firm], without tying the purchasers by a formal obligation, applies, either under the terms of agreements concluded with these purchasers or unilaterally, a system of fidelity rebates, that is to say discounts conditional on the customer’s obtaining all or most of its requirements, whether the quantity of its purchases be large or small, from the undertaking in a dominant position*”.

5. The decisional practice of the Commission and the case law of the European Courts have covered various types of rebates and discounts, from discounts conditional upon the acceptance by customers of meeting the totality of their requirements from the dominant undertaking (e.g. *Suiker Unie*³) to schemes that do not explicitly depend on any customer's obligation to achieve all or most of his requirements from the dominant undertaking, but have the same loyalty inducing and exclusionary effects. The latter include selective target rebates (whereby the rebate is granted on the basis of the customer having reached a specified sales target fixed individually between the dominant undertaking and its customer (e.g. *Michelin I*⁴, *Coca Cola*, *Irish Sugar*⁵, *British Airways*⁶, ...) and generally applicable volume rebates (*Michelin II*⁷).

¹ Discounts are generally offered on individual transactions, whereas rebates are normally deductions or cash payments made to a customer in accordance with the latter’s purchases over a period of time. Although the terms “discounts” and “rebates” are used interchangeably in this document, the emphasis of the document is on rebates.

² ECJ 13 February 1979, Case C-85/76, *Hoffmann-La Roche v. Commission*

³ ECJ 16 December 1975, Case C-40/73, *Suiker Unie v. Commission*

⁴ ECJ 9 November 1981, Case C-322/81, *NV Nederlandsche Banden Industrie Michelin v. Commission*

⁵ CFI 7 October 1999, Case T-228/97, *Irish Sugar plc v Commission*

⁶ CFI 17 December 2003, Case T-219/99, *British Airways plc v. Commission*

6. Central to the Commission's and the Court's assessment have been the criteria and rules governing the grant of the discount, such as the length of the reference period upon which the rebate is calculated, and linked to that the amount of the rebate that the customer would lose in case it switches (part of) its demand to a rival of the dominant firm, and the degree to which the criteria for granting the rebate are objectively related to specific efficiencies and thus non-discriminatory.

7. For example in the first *Coca-Cola* case, which was resolved without the need for a formal decision, the Commission objected to Coca-Cola's target rebate scheme for its customers in Italy, which used a reference period of one year for the calculation of the rebate. As in *Michelin I*, the Commission felt that such a scheme had a tying effect on purchasers, thereby substantially foreclosing the market to Coca-Cola's competitors. When the company volunteered to reduce the reference period to three months, the Commission accepted that the scheme no longer substantially impeded the company's customers from switching suppliers

8. The selective target rebates in the *Irish Sugar* decision, which was upheld by the Court of First Instance, provides an example of a scheme that the Court considered as not being governed by objective efficiency related award criteria and having the effect of discouraging competition.

9. The Commission has also pronounced on so-called top-slice rebates which is a specific form of incremental rebates. Purchasers sometimes obtain the bulk of their requirements from a single supplier and the rest from elsewhere and the dominant undertaking seeks to induce the purchaser to purchase in addition that remnant (the so-called "top-slice") from it by offering a special discount on the top slice tonnage (*ICT*⁷, *Solvay*⁸). Furthermore, the Commission has issued decisions, up-held by the European Courts, on bundled discounts, i.e. a situation where a bundle of different products being is sold at a discount to the sum of the prices of the components (e.g. *Hoffman-La Roche*).

10. The Commission has been analysing the potential anti-competitive effects of discounts and rebates granted by dominant undertakings as part of its on-going reflection on the policy underlying the implementation of Article 82 and the way in which it should enforce that policy, which is guided by an effects-based approach to the assessment of the practices of dominant undertakings.

2. Analytical framework for assessing single product rebates

11. Rebates are generally granted to customers to reward them for a particular form of purchasing behaviour, i.e. they are "conditional". The usual nature of a conditional rebate is that the customer is given a rebate if its purchases over a defined reference period exceed a certain threshold, the rebate being granted either on all purchases (retroactive rebates) or only on those made in excess of those required to achieve the threshold (incremental rebates).

12. The Commission considers that single product rebates, in that they may lock-in customers and foreclose a dominant company's competitors by hindering them from selling to customers, are a form of exclusive dealing.

13. The likelihood of anticompetitive foreclosure is higher where there are no viable substitutes for the dominant supplier's product and / or where competitors are not able to compete on equal terms for the entire demand of each individual customer. If the dominant supplier is an unavoidable trading partner, a

⁷ CFI 30 September 2003, Case T-203/01, *Manufacture française des pneumatiques Michelin v. Commission*

⁸ Commission Decision of 19 December 1990 n°91/299/CE (OJ L 152/21 of 15.6.1991).

⁹ Commission Decision of 19 December 1990 n°91/300/CE (OJ L 152/40 of 15.6.1991).

conditional rebate may enable the dominant supplier to use the 'non contestable' portion of the demand of each customer (i.e. the amount that would anyhow be purchased by the customer from the dominant firm) as leverage to decrease the price to be paid for the 'contestable' portion of demand (i.e. the amount for which the customer may prefer and be able to find substitutes).

14. In general terms, retroactive rebates may foreclose the market significantly, as they may make it less attractive for customers to switch small amounts of demand to an alternative supplier, if this would lead to loss of the retroactive rebates. The higher the rebate as a percentage of the total price and the higher the threshold, the greater the inducement below the threshold and, therefore, the stronger the likely foreclosure.

15. It is normally important to consider whether the rebate system is applied with an individualised or a standardised threshold. An individualised threshold – one based on a percentage of the total requirements of the customer or an individualised volume target - allows the dominant supplier to set the threshold at such a level as to make it difficult for customers to switch suppliers, thereby creating a maximum loyalty enhancing effect. By contrast, a standardised volume threshold – where the threshold is the same for all or a group of customers – may be too high for some smaller customers and/or too low for larger customers to have a loyalty enhancing effect. If, however, it can be established that a standardised volume threshold is tailored to the requirements of a significant proportion of customers, the Commission considers that such a standardised system of rebates may produce anticompetitive foreclosure effects.

16. If sufficiently reliable data are available or can be obtained the Commission will investigate whether the rebate system is capable of hindering the expansion or entry of 'as efficient' competitors by making it more difficult for them to supply part of the requirements of individual customers. In applying the 'as efficient' competitor benchmark the Commission will estimate what price a rival would have to offer in order to compensate the customer for the loss of the conditional rebate if the latter would switch a part of his demand ('the relevant range'). The effective price that the customer faces in deciding from whom to purchase, and which the rival will thus have to match, is not the average price of the dominant firm, but the normal (list) price less the rebate it loses by switching, calculated over the relevant range of sales.

17. The relevant range over which to calculate the effective price in a particular case depends on whether the rebate is incremental or retroactive. For incremental rebates, the Commission considers that the relevant range is the incremental purchases that are being considered. For retroactive rebates, it will generally be relevant to assess in the specific market context how much of a customer's purchase requirements can realistically be switched to a rival. If customers are likely to be willing and able to switch large amounts of demand to a (potential) rival relatively quickly, the relevant range is likely to be relatively large. If on the other hand customers are likely only to want or be able to switch small amounts incrementally, then the relevant range will be relatively small. For existing competitors their capacity to expand sales to customers and the fluctuations in these sales over time may also provide an indication of the relevant range. For potential competitors it is important to assess at what scale a new entrant would realistically be able to enter. It may be possible to take the historical growth pattern of new entrants in the same or in similar markets as an indication of a realistic market share of a new entrant.

18. The lower the estimated effective price is compared to the average price of the dominant supplier, the stronger the loyalty-enhancing effect. However, as long as the effective price remains above the long

run average incremental cost (LRAIC)¹⁰ of the dominant undertaking, this would normally allow an equally efficient competitor to compete profitably notwithstanding the rebate. In those circumstances the rebate is normally not capable of foreclosing anti-competitively.¹¹ Where the effective price is below average avoidable cost (AAC)¹², as a general rule the rebate scheme is capable of foreclosing as efficient competitors. Where the effective price is between AAC and LRAIC, it is important to investigate whether other factors point to the conclusion that entry or expansion by as efficient competitors is likely to be affected. In this context, the Commission will investigate whether and the extent to which rivals have counterstrategies at their disposal, for instance whether and to what extent competitors are also able to use a ‘non contestable’ portion of the buyer’s demand as leverage to decrease the price for the relevant range. Where competitors do not have sufficient possibilities to match the effective price, the Commission will consider that the rebate scheme is capable of foreclosing equally efficient competitors.

3. Analytical framework for assessing multi-product rebates

19. The previous section related to rebate systems applied by a dominant undertaking for a particular product and which have their possible negative effect in the market where the undertaking is dominant. Mixed bundling, or multi-product rebates, refers to situations where a bundle of different products is sold at a discount compared to the sum of the prices of the products when purchased separately. Such multi-product rebates can have exclusionary effects in a number of markets simultaneously.

20. Multi-product rebates are part of the category of abuse commonly referred to as ‘tying and bundling’. “Tying” usually refers to situations where customers that purchase one product (the tying product) are required also to purchase another product from the dominant undertaking (the tied product). “Bundling” usually refers to the way products are offered and priced by the dominant undertaking. In the case of pure bundling the products are only sold jointly in fixed proportions. In case of mixed bundling, the products are also made available separately, but the sum of the prices when sold separately is higher than the bundled price (i.e. the dominant undertaking offers a multi-product rebate).

21. In the case of bundling, the undertaking may be in a dominant position for more than one of the products of the bundle. The anticompetitive foreclosure is likely to be stronger the greater the number of such products in the bundle. This is particularly true if the bundle is difficult for a competitor to replicate, either on its own or in combination with others.

22. A multi-product rebate may be anticompetitive on the tied or the tying market if it is so large that efficient competitors offering only some of the products cannot compete against the discounted bundle.

23. In its enforcement practice the Commission, to apply the as efficient competitor test, will assess the incremental price and compare it to the relevant cost benchmark. If the incremental price that customers pay for each of the dominant undertaking’s products in the bundle remains above the LRAIC to

¹⁰ Long-run average incremental cost (LRAIC) is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. Average total cost (ATC) and LRAIC are good proxies for each other, and are the same in the case of single product undertakings. If multi-product undertakings have economies of scope, LRAIC would be below ATC for each individual product, as true common costs are not taken into account in LRAIC. In the case of multiple products, any costs that could have been avoided by not producing a particular product or range are not considered to be common costs.

¹¹ In situations where common costs are significant, they may have to be taken into account when assessing the ability to foreclose as efficient competitors.

¹² Average avoidable cost (AAC) is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case the amount allegedly the subject of abusive conduct. In most cases, the average variable cost (AVC) and AAC will be the same, as it is often only variable costs that can be avoided

the dominant firm of including this product in the bundle, the Commission will normally not intervene since an equally efficient competitor with only one product should in principle be able to compete profitably against the bundle. Enforcement action may however be warranted if the incremental price is below the LRAIC, because in such case an equally efficient competitor may be prevented from expanding or entering.

24. If the evidence suggests that competitors to the dominant undertaking are also selling bundles, the Commission will generally regard this as bundle competing against bundle, in which case the relevant question is not whether the incremental revenue covers the incremental costs for each product in the bundle, but rather whether the price of the bundle as a whole is predatory.

4. Efficiencies of single and multi-product rebates

25. The Commission will consider evidence demonstrating that rebate systems achieve cost advantages which are passed on to customers. Rebate schemes with individualised volume targets are generally less likely to achieve such advantages than those with standardised volume targets.

26. Conditional rebates, by allowing the dominant undertaking to secure that the customer purchases at least a certain minimum amount over a sufficiently long period, can provide incentives for the dominant undertaking to make certain relationship-specific investments in order to be able to supply a particular customer.

27. The bundling present in multi-product rebates may lead to savings in production, distribution or transaction costs. Combining two independent products into a new, single product may be an innovative way to market a product. It may also save transaction costs for customers and it may allow suppliers to save on packaging and distribution costs. It may also allow the supplier to pass on efficiencies arising from its production or purchase of large quantities of the tied product.

28. Some commentators argue that both the Commission and the European Courts have failed to consider (sufficiently) possible efficiencies on the demand side. Although the debate is far from closed, it seems that the Commission and the Courts did concentrate on the exclusionary effects for efficient rivals of the dominant firm rather than on the possible direct benefits that a rebate system may provide to the dominant firm's customers. Lately there has been a shift in the Commission's and European Courts' practice which, more clearly than in the past, ensures that efficiencies are taken into account by allowing the dominant firm to show that the efficiencies are likely to outweigh the anti-competitive effects to the benefit of consumers.¹³

5. Intent

29. Under EC competition law, the concept of abuse is an objective one: there cannot be any finding of abuse based on intent only. However, the Commission may look at internal documents or business plans

¹³ ECJ, 15 March 2007, C-95/04P, *British Airways plc v. Commission*, §86 ("Assessment of the economic justification for a system of discounts or bonuses established by an undertaking in a dominant position is to be made on the basis of the whole of the circumstances of the case (...). It has to be determined whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer. If the exclusionary effect of that system bears no relation to advantages for the market and consumers, or if it goes beyond what is necessary in order to attain those advantages, that system must be regarded as an abuse.").

See also CFI, 17 September 2007, Case T-201/04 *Microsoft Corp. v. Commission*, §688, §709, §710, §1144.

of the dominant undertaking that suggest that there is a strategy whereby the discounts or rebates are used to foreclose competitors. This may be relevant for the assessment of the likely effects of the discount or rebate scheme.