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REBATES: COMPETITION ON THE MERITS OR EXCLUSIONARY PRACTICE ?

by

Luc Gyselen

The author is Head of Unit at the Directorate General for Competition of the European Commission. All views expressed in this written contribution are strictly personal to him. This contribution was presented at the European University Institute, Florence on 6-7 June 2003. It will be published in *European Competition Law Annual : What is an Abuse of a Dominant Position ? »*, Hart Publishing of Oxford (anticipated timing : winter 2003/2004).

INTRODUCTION

1. The distinction between pricing and non-pricing abuses is a relative one. They can indeed be the two sides of the same coin.[1] Alternatively, pricing abuses (e.g. fidelity rebates) might be the – on paper - less restrictive alternative to non-pricing abuses (e.g. exclusive dealing).[2] The agenda of the 2003 EUI Workshop's second session is to focus on exclusionary pricing abuses (as opposed to exploitative pricing abuses, such as excessive pricing). These exclusionary abuses essentially include predatory pricing, discounting practices and discriminatory pricing affecting primary line competition.[3]

2. The present paper will focus on discounting practices. For a start, this will keep the paper's size within digestible limits. More importantly, the 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 of a *per se* approach in doing so [4] whereas in the U.S. antitrust agencies do not seem to have deployed any public enforcement activity at all[5] and federal courts assess private suits under an – all-

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[1] When a dominant company maximises its profits by restricting output and raising prices, it may "limit production" within the meaning of Art. 82 (b) as well as "impose unfair [read: excessive] selling prices" within the meaning of Art. 82 (a).

[2] See the Court's statements with regard to fidelity rebates and non-compete obligations in case 85/76, *Hoffmann-La Roche v. Commission*, (1979) ECR p. 461 at § 89. Fidelity rebates may also reward compliance with non-compete obligations (as was partly the case in *Roche*).

[3] These pricing practices may occur in combination. See e.g. *Akzo*, a case best known as the first predatory pricing case but also involving price discrimination (O.J. L 374/1 of 31-12-1985 upheld by the ECJ in case C-62/86, Akzo v. Commission (1991) ECR I-3359). Reference can also be made to the fidelity rebate cases where the Commission and Courts have often held against the dominant companies that they discriminate between the loyal customers and the others thereby restricting secondary line competition between them.

[4] *European Sugar Industry* (O.J. L 140/17 of 26-05-1973), *Hoffmann-La Roche* (O.J. L 223/27 of 16-08-1976), *Michelin I* (O.J. L 353/33 of 09-12-1981), *Hilti* (O.J. L 65/19 of 11-03-1988), *BPB Industries* (O.J. L 10/50 of 13-01-1989), *Solvay* and *ICI* (O.J. L 152/21 and L 152/40 of 15-06-1991), *Irish Sugar* (O.J. L 258/1 of 22-09-1997), *Virgin/British Airways* (O.J. L 30/1 of 04-02-2000), *Michelin II* (O.J. L 143/1 of 31-05-2002) and *Deutsche Post* (O.J. L 125/27 of 05-05-2001).

[5] See Note by the United States for the « Roundtable on loyalty or fidelity discounts and rebates » held at the OECD on 29th May 2002 : « The U.S. antitrust agencies cannot recall any enforcement actions challenging « market share » discount schemes, but a number of recent private suits have started to develop the law in this area ». As will be seen, the so-called « market share » discount schemes (i.e.

in-all deferential *rule of reason* approach[6]. No wonder several commentators perceive the EC Commission's policy in this area as a controversial one.[7]

3. One terminological point before we kick off. One usually refers to "fidelity" or "loyalty" rebates to denote the discounting practices which may raise antitrust concern under Art. 82 E.C. Treaty or Section 2 of the Sherman Act and to "quantity" rebates to describe the lawful discounting practices. However, these labels are anything but self-explanatory. The common denominator of most "fidelity" rebate schemes condemned by the EC Commission was that the dominant company granted the rebates to its customers provided that they would achieve certain *individualised volume targets* during a certain reference period. We will refer to these systems as target rebate systems. The question to be addressed (and clarified) is how these schemes influence the switching costs for customers and artificially raise the barriers to entry for the dominant company's competitors.

4. This paper will start with a few personal reflections about a conceptual framework for the application of Article 82 in general (part I). This will be followed by a survey of the existing E.C. case law concerning rebates granted by dominant

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schemes under which the dominant company ties the rebate to its share in the customer's total purchases) are among those considered to be virtually *per se* unlawful under Art. 82 EC Treaty.

[6] Roughly speaking, the U.S. federal courts seem to be reluctant to challenge single product discounts - even if they are « market share » discounts rewarding *de facto* a certain degree of exclusive dealing - unless these discounts involve below cost pricing : see e.g. *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000) and *Virgin Atlantic Airways Ltd. V. British Airways PLC*, 69 F. Supp. 571 (S.D.N.Y. 1999), aff'd 257 F.3d 256 (2d Cir. 2001). Multiproduct discounts rewarding the purchase of a range (or bundle) of products – which typically includes products for which the dominant company does not hold monopoly power – stand a somewhat better chance of being challenged even if they do not involve below cost pricing: see e.g. *SmithKline Corp. v. Eli Lilly & Co*, 427 F. Supp. 1089 (E.D. Pa. 1976), aff'd 575 F. 2d 1056 (3d Cir. 1978) and more recently the Third Circuit Court of appeals' judgement in *LePage's Inc. v. 3M* from 25 March 2003.

[7] John Temple Lang, Defining legitimate competition : how to clarify pricing abuses under art. 82 EC, 26 Fordham Int'l L. J. 83-162., at 86 : « it is perhaps in regard to these practices that certain Commission statements appear to deviate most from established economic thinking » and at 108 : « the Commission has made certain statements on rebate practices that would be extremely troubling if they were understood to represent the general state of the law on discounting ». See also Brian Sher, Pricing abuse under article 82 – comments on case studies, IBC 8th Annual Conference – Brussels 15 November 2001 : « ….there is nowhere in the case law or decisional practice of the Commission an attempt to separate out and « build up » one by one the different factors which appear to have caused particular concern ».

companies (part II). Thereafter we will draw some operational conclusions from this case law (part III).

PART I A CONCEPTUAL FRAMEWORK FOR THE APPLICATION OF ARTICLE 82

5. Many commentators deplore that the European Commission has not yet come up with a conceptual framework which would enable dominant companies to properly assess the risk that their pricing or non-pricing practices run foul of Art. 82 EC Treaty. They refer to what the Commission has done – or is in the process of doing – in the other areas of antitrust law.[8] These commentators often add that a conceptual framework for assessing practices under Art. 82 is needed because there are – in their view - no practices which are *per se* abusive. In fact they criticise the Commission for adopting a *per se* approach, i.e. for qualifying as abusive certain practices which – allegedly - do not at all restrict competition in the relevant market or are objectively justified. Paradoxically, it is with regard to pricing practices - in particular rebate practices for which, as mentioned above, the case law is the most developed - that the commentators take the view that the policy lacks conceptual clarity.[9]

6. If there is a need for conceptual clarification it is undoubtedly because abuse cases are far more facts-specific that any other type of antitrust case. The Commission often has to « decode » the dominant company's practice because this company obviously has no interest in labelling its non-pricing or pricing practices in suspicious terms.

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[8] See the Commission Guidelines on vertical restraints (O.J. C 291/1 of 13-10-2000) and on horizontal restraints (O.J. C 3/2 of 6-1-2001) which essentially deal with the applicability of Art. 81 EC to such restraints (leaving aside a few short references to the applicability of Art. 82 EC : see e.g. §141 in fine of the Guidelines on vertical restraints). See also draft Commission Notice on the appraisal of horizontal mergers (O.J. C 331/18 of 31-12-2002-and preliminary draft notice on non-horizontal mergers (not yet published).

[9] See fn. 7.

7. Leaving aside the facts-specific nature of (pricing or other) abuse cases, it is commonly known that dominant companies may run into trouble either because they charge too high prices or because they offer too low prices.[10] The first case is - conceptually - more straightforward than the second case and will not be dealt with in this paper. It is nevertheless useful to explain why excessive pricing is – conceptually – easier to come to grips with under Art. 82 than the range of exclusionary pricing practices.

8. *Excessive pricing*. A dominant company which charges excessively high prices directly harms the interests of its customers and is likely to do the same with the latter's downstream clients. Since the *raison d'être* of antitrust policy is *in fine* to preserve consumer welfare, no one seriously contests the view that a dominant company's excessive pricing can be abusive. Besides, as noted above, Art. 82 (a) expressly prohibits this type of "unfair" pricing and gives the European Commission (or a national court) a mandate to intervene *even if* there is a possibility that the excessive prices might attract third competitors and be – in that sense - pro-competitive. In other words, the Founding Fathers' faith in competition as a process of rivalry between competitors was not strong enough to tolerate customer/consumer exploitation in the short run. Of course, they left the antitrust enforcer the freedom *not* to intervene in cases where it holds solid evidence that the excessive pricing will *immediately* trigger new market entry. In such cases, its intervention would be a waste of resources. Moreover such evidence would cast doubt over the existence of the company's alleged dominant position in the first place. However, outside these cases, the case for challenging excessive prices is pretty straightforward in conceptual terms. All it takes to intervene is to establish an illegality threshold (i.e. when does a price become excessive?) and to collect the evidence that the price has exceeded that threshold.

[10] We are aware that this is an extreme simplification. For the pricing abuses which will be the subject of this paper, i.e. rebates, the trouble does not lie with the level of the net price as such but with the link between the rebate and the *quid pro quo* required from the customer. It is this combination which influences the customer's switching costs and may raise the entry barriers for the dominant company's competitors.

This may be far from easy but the only point we wish to make here is that it does not raise fundamental conceptual problems.

9. *Predatory pricing, rebates and other forms of exclusionary pricing practices*. Things are more complicated with regard to all pricing practices whereby a dominant company seeks to exclude its competitors from the market or at least contain their growth. The dominant company tends to make its customers (and possibly also their downstream clients) happy with low prices. However, the trouble with these exclusionary pricing practices is that they may artificially foreclose business opportunities for the dominant company's competitors and that – as a consequence – they may harm the competitive process.

10. The antitrust enforcer's intervention in these cases is - conceptually speaking – trickier than in the case of excessive pricing because it is inspired by faith in competition as a 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 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 all of them. It is of course easy to state this point in general terms. Where to draw the line in the concrete cases at hand is another matter. Any controversy in such cases – however simple or complex their facts may be - is likely to boil down to this crucial line-drawing issue. The answer is – again in general terms – that dominant companies will be living dangerously under Art. 82 when they offer prices which equally efficient rival competitors cannot match.

11. In the exclusionary pricing cases, there are - in our view - two main questions to be addressed. The first question is what degree of foreclosure the Commission must demonstrate to justify its intervention. The second question is what type of efficiencies the dominant company can invoke as objective justification for whatever foreclosure its pricing practices may create.[11] The underlying thought

[11] For a systematic overview of all exclusionary abuse cases from the eighties in light of this two-tier approach, see Luc Gyselen, Abuse of Monopoly power within the meaning of Article 86 of the EEC Treaty : recent developments, in : 1989 Fordham Corporate Law Institute pp. 597-650.

behind this second question is that dominant companies are free to expand their market share at the expense of their competitors as long as they compete on the merits (which means that their market behaviour has an "objective justification").

12. This two-tier assessment of a dominant company's conduct under Art. 82 is similar to the two-tier assessment of an agreement between several companies under Art. 81. In our view, the circumstance that Art. 82 – unlike Art. 81 – lacks a provision which provides dominant companies with an explicit legal basis for invoking objective justifications for their market behaviour is immaterial since the purpose of Art. 82 cannot be to deprive dominant companies of the possibility to outcompete their rivals with lawful means.

13. As a matter of fact, in its Guidelines on vertical restraints the Commission has recognised the possibility for a dominant company to justify its allegedly abusive practices twice – once in the context of Art. 82 and once in the context of Art. 81-1. Addressing the issue of single branding, the Commission observes that "dominant companies may not impose non-compete obligations on their buyers unless they can objectively justify such commercial practices within the context of Article 82".[12] Incidentally, this excerpt implies that non-compete obligations are forbidden in principle without it being necessary to show appreciable foreclosure. In other words, this prohibition skips the first step in the two-tier approach.

14. In an earlier passage about vertical restraints in general, the Commission notes that "where an undertaking is dominant (…), a vertical restraint that has appreciable anti-competitive effects can in principle not be exempted" but "the vertical agreement may (…) fall outside Art. 81-1 if there is an objective justification".[13] At first sight, the Commission diverts from the prevailing view according to which Art. 81-1 only allows for a weighing of the procompetitive and anticompetitive effects of agreements whereas the assessment of objective justifications for otherwise restrictive agreements must take place within the

[12] See § 141 *in fine* of theGuidelines.

[13] Ibidem, § 135.

framework of Art. 81-3.[14] However, even under Art. 81-3, the success of an efficiency defense ultimately depends on whether or not the agreement substantially lessens competition.[15] If the agreement does, there will usually be a strong presumption that the parties to the agreement will not pass on to consumers whatever efficiencies their agreement will have generated and hence that these consumers will not get their "fair share of the resulting benefit" – as Art. 81-3 puts it.[16]

15. We will now briefly explain the relevance of the two-tier approach for exclusionary pricing practices before commenting in detail the case law related to one particular type of such practices, i.e. the granting of fidelity rebates.

a) foreclosure

16. Several foreclosure scenarios may present themselves.

17. Predatory intent. The first scenario is – at first sight – an easy one: there is evidence of exclusionary intent. The dominant company deliberately targets a competitor, e.g. by approaching its customers selectively with low prices. Predatory and discriminatory prices come in combined form.[17] This first scenario is not always as simple as it looks. Internal documents showing the dominant company's exclusionary intent without evidence that it has been followed by

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[14] The prevailing view is not without qualification. In *Wouters and others v. NOVA* (case C-309/99, 19-02-2002, § 97), the Court diverts from it by observing that public interest grounds can take an agreement outside the scope of Art. 81-1. Conversely, in *European Night Services* (cases T-374-375, 384 and 388/94, ECR II-3141, § 136), the Court of First Instance observes that one can weigh the pro- and anti-competitive effects of hard core cartels under Art. 81-3.

[15] Or to restate the somewhat bizarre terms of Art. 81-3 *in fine*: whether an agreement "… does not afford [the] undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

[16] Cf. the efficiency defense debate in the context of the current merger review. In its draft notice on the appraisal of horizontal mergers (O.J. C 331/18 of 31-12-2002), the Commission observes that « it is necessary to ensure that the merged firm will have sufficient incentives not only to realise the efficiencies arising directly from the merger but also to make continuing efforts to enhance efficiency » and that « *this presupposes sufficient competitive pressure* from the remaining firms and from potential entry » (§ 88 *in fine* – italics added). As under Art. 81-3, the process-oriented view of competition appears to prevail.

[17] See fn 4.

objectively unlawful behaviour in the market will not take the case anywhere. In other words, evidence of exclusionary intent is not a sufficient condition for the applicability of Art. 82. Nor is it a necessary condition for the applicability of Art. 82.[18] However, the availability of "smoking gun" material may assist the antitrust enforcer in addressing (and rebutting) the dominant company's defense in so far as it will prevent the latter from invoking phony *ex post* objective justifications for its behaviour. The *Akzo* case provides a telling example of this.[19]

18. Actual foreclosure. In a second scenario, there is empirical evidence that the dominant company's market behaviour has actually produced foreclosure effects to the detriment of its competitors. Dealing with single branding in its Guidelines on vertical restraints, the Commission observes that "for a dominant company, even a modest tied market share may already lead to significant anti-competitive effects" and that "the stronger its dominance, the higher the risk of foreclosure of other competitors.[20] This passage suggests a) that the Commission will quickly conclude that there is a problem ("even a modest tied market share…") but also b) that it will apply Art. 82 as soon as there is potential foreclosure ("… may already lead to significant anti-competitive effects"). As a matter of fact, the Courts have never invalidated a Commission prohibition decision under Art. 82 because it would have lacked evidence of actual foreclosure.[21] One can draw an analogy

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[18] Abuse is an objective concept. It can occur in the absence of any fault on behalf of the dominant company. See case 6/72, *Continental Can v. Commission* (1973) ECR p. 215 at § 27.

[19] Akzo justified its low, but above average variable-cost, prices on the ground that they made a positive contribution towards the coverage of its fixed costs and that it was therefore always better to sell at those prices than not to sell at all and still bear the fixed costs. The Commission had, however, obtained "smoking gun" material showing that Akzo had the clear intention to selectively approach ECS's customers with low prices in the flour additives market where ECS was still making its entire turnover in order to nip in the bud its potential competition on the plastics market. See also the Commission's decision *ICI* (cit. footnote 4) at § 38.

[20] See § 148 *in fine* of the Guidelines.

[21] See case C-62/86, *Akzo* (cit.) §163 (absence of actual harm only a mitigating factor for the level of the fine) and joined cases T-24-26/93 and 28/93, *Compagnie Maritime Belge and others v. Commission*, (1996) ECR II-1201 § 149 (« The Court however considers that, where one or more undertakings in a dominant position actually implement a practice whose aim is to remove a competitor, the fact that the result sought is not achieved is not enough to avoid the practice being characterized as an abuse of a dominant position within the meaning of Article 86 of the Treaty. Besides, contrary to the applicants' assertions, the fact that G & C's market share increased does not mean that the practice was without any effect, given that, if the practice had not been implemented, G

with Art. 81 which covers agreements which have as their « object *or* effect » to restrict competition. Hence, while being a sufficient condition, actual foreclosure is not a necessary condition for the applicability of Art. 82. This brings us to the third scenario.

19. Potential foreclosure. In a third scenario, the factual circumstances show that the dominant company's market behaviour is capable of producing appreciable foreclosure effects to the detriment of its competitors. In contrast with the proof of exclusionary intent or actual foreclosure, proof of potential foreclosure is – in our view - a necessary condition for the application of Art. 82 EC. Without such proof, there seems to be little point in pursuing any abuse case. The dominant company will typically try to challenge the finding of potential foreclosure by arguing that the market circumstances make it unlikely or impossible. It will be the Commission's duty to rebut this argument.

20. Since demonstration of appreciable potential foreclosure effects is necessary, the Commission must always assess the allegedly abusive practices in their market context. In this sense, one could perhaps say that there are no *per se* abuses. However, it also means that a dominant company will not get away with its otherwise abusive practices merely by labeling them in an inventive way, by advancing economic justifications unconnected to the facts at hand or even by copying practices tolerated in the past on the basis of different or incomplete factual data. What indeed matters is to know (or find out) how a particular practice works out in the real world. The Court has already confirmed that a payment which has in all material respects the features of an unlawful fidelity rebate will not escape muster, simply because it bears a neutral name tag[22] or the label "quantity rebate".[23]

& C's share might have increased more significantly"). In case T-228/97, *Irish Sugar v. Commission*, (1999) ECR II-2969, § 191, the CFI quotes the first sentence of this passage again.

[22] Cf *Roche* judgment at §96 : « It is true that in four of the contracts (…) the reason why the rebate is allowed on all purchases, according to the terms of the said contracts, is that these customers guarantee to Roche payment of the bills resulting from orders placed directly by subsidiaries of those customers. It is neverthelss difficult to accept that rebates calculated in all respects on the same basis as those which in the other contracts are acknowledged to be fidelity rebates, can be consideration for an undertaking by international companies (…) designed to reassure Roche that their subsidiaries are solvent ».

b) objective justifications

21. Where there is evidence of potential or actual foreclosure, the dominant company's market behaviour cannot be considered as abusive unless it is clear that it *unduly* forecloses business opportunities for its competitors. Even a dominant company has indeed the right to compete on the merits for more business. It must therefore be given the chance to advance objective justifications for its behaviour.[24]

22. It remains unclear which standard of proof a dominant company faces when it invokes objective justifications (or - to use a more fashionable term – an efficiency defense) for the alleged abuse. For a start, the dominant company must surely demonstrate that its allegedly abusive conduct (and nothing else) generates the efficiencies.[25] Furthermore, the efficiencies must verifiable, i.e. quantifiable.[26] Finally, the dominant company must meet a proportionality test: it must show that its conduct is a proportionate means to achieve a legitimate end (i.e. the efficiencies). The question – perhaps the hardest question of all – is how to circumscribe the proportionality test in the context of Art. 82. Under a "softer" version, the Commission and Courts would accept to balance off the size of the efficiencies against the magnitude of the actual or potential harm for competition. Under a "stricter" version, the dominant company would have to demonstrate that it could not do business without the alleged restraint of competition. Support for the latter version can be found in Advocate General Cosmas' opinion in

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[23] See e.g. § 499 of the Court's judgement in joined cases 40-48, 50, 54-56, 111, 113 and 114/73, *Suiker Unie and others v. Commission*, (1975) ECR, p. 1663.

[24] See e.g. case 27/76, *United Brands v. Commission*, (1978), ECR 207 at § 184 (« it is therefore necessary to ascertain whether the discontinuance of supplies by UBC in October 1973 was justified »). See also case 85/76 Roche (cit.) at § 90 where it observes that the non-compete obligations *viz.* incentives « are not based on an economic transaction which justifies this burden or benefit ».)

[25] An analogy can be drawn with the Commission's draft notice concerning the efficiency defense in horizontal merger cases (O.J. C 331/18 of 31.12.2002) which requires that the efficiencies be « merger-specific » (cf. §§ 90 and 93).

[26] Ibidem, §§ 90 and 94.

Masterfoods according to which the dominant company must demonstrate that it would not be in a position to do business (*in casu* sell ice cream in freezers) without the vertical restraint at stake (*in casu* the supply of exclusive zero-rental freezers).[27] In other words, the dominant company must show that the restraint is necessary to compete on the merits and, as a consequence, that its allegedly restrictive conduct is in fact pro-competitive.

23. As said, the case law does not offer much guidance. Efficiency arguments are indeed usually dismissed without a detailed analysis. The case law on rebates provides a telling example. It is therefore time to turn to a survey of this case law.

PART II CASE LAW ON REBATE SYSTEMS OPERATED BY DOMINANT COMPANIES

24. In our view, the existing case law on rebates covers - by and large - three types of situations.

25. In the first situation, the dominant company grants rebates to customers in return for a full or partial exclusive dealing arrangement. The rebates will fluctuate with the dominant firm's share in its customers' business. In the U.S., they are known as "market share" discounts. There are several cases in which such rebates have been condemned as fidelity enhancing. We refer – in chronological order - to *European Sugar Industry*, *Hoffmann-La Roche*, *British Plasterboard*, *Solvay, ICI* and *Deutsche Post*. [28] Sometimes the case file informs us about monitoring mechanisms which the dominant companies use to check whether their customers really remain loyal to them and deserve the fidelity rebate. Typically the dominant companies will make estimates of their customers' purchase requirements for a future reference period and pay the customers afterwards a

[27] Opinion of 16 May 2000 in case C-344/98, Masterfoods v. HB Ice Cream (2000) ECR I-11.371 § 88 and footnote 80 in this opinion.

[28] Cit. footnote 4.

rebate the level of which will depend on whether these customers have approximated, reached or exceeded these estimates. In other cases, the case file does not contain details about such monitoring mechanisms and one can only assume that the dominant companies must have done something similar to measure their customers' degree of loyalty.

26. In the second situation, there is no explicit (full or partial) exclusive dealing condition attached to the grant of the rebates. However, the dominant company will grant rebates to customers on the basis of a comparison between the volumes which they have purchased in a past reference period and the volumes they are estimated to purchase during a corresponding future reference period. In other words, as in the first situation, the dominant companies will have made estimates of their customers' purchase requirements. These customers will need to reach certain individualized volume targets in order to benefit from the rebates. Typically, they will receive these target rebates if they purchase from the dominant company volumes matching or exceeding the volumes which they have purchased from it in the past. Here we refer – again in chronological order - to *Michelin I*, *Irish Sugar, Virgin/British Airways* and – partly – *Michelin II.*[29]

27. In a third situation, the grant of the rebates is also conditional upon the customers reaching certain volume levels during a certain reference period but these levels are no longer individualised. Instead of being based on a comparison between each customer's past and future purchasing policy, these volume levels are standardized for all customers. We only find this third situation - in part - in *Michelin II.*

SECTION 1 REBATES LINKED TO EXCLUSIVE DEALING

1.1 European Sugar Industry[30]

[29] Ibidem.

[30] Commission decision, cit. footnote 4 and Court judgement, cit. footnote 18.

facts

28. In this Decision which concerns essentially a cartel between European sugar producers, the Commission also challenges a rebate scheme which one of them (Südzucker) had set up under the label "annual quantity rebates". Südzucker rewarded customers provided they bought all their annual purchase requirements from it. We guess (but the case file does not tell) that Südzucker made estimates of its customers' purchase requirements in order to be sure that it would only reward loyal customers. Usually, it paid a rebate amounting to 0,3% of the customers' yearly turnover. In some cases, it calculated an identical rebate on the basis of the sales price and immediately deducted it from the invoice price.

assessment

29. According to the Commission, "the granting of a rebate which does not depend on the amount bought, but only on whether the annual requirements are covered exclusively by SZV is an unjustifiable discrimination against buyers who also buy from sources other than SZV" and the Court confirms this.[31] Hence, the focus is on the rebate's impact on secondary line competition (between Südzucker's customers)

30. The fidelity-enhancing nature of this rebate - and therefore its impact on primary line competition between Südzucker and its rival competitors - comes as a second objection. According to the Commission, a rival competitor will find it hard to beat a rebate – even a small one – which is calculated on the basis of a customer's total, rather than incremental, yearly turnover. The Commission even states that "such favourable offers are (…) practically ruled out.[32] The Court does not narrow down its assessment to the calculation basis. It observes in general terms that « the rebate at issue is not to be treated as a quantity rebate exclusively linked

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[31] See L 140/39-40 for the Decision and § 522 of the judgement.

[32] See L 140/40 for the Decision.

with the volume of purchases from the producer concerned but has rightly been classified by the Commission as a loyalty rebate designed, through the grant of a financial advantage, to prevent customers obtaining their supplies from competing producers».[33]

31. Neither the Commission nor the Court are impressed by the fact that in some cases, SZV immediately deducted the rebate from the invoice price. To use the Court's words, even "this method of granting a rebate also dissuades the customers concerned from obtaining their supplies from other producers, as they had to fear that, if they did so, they would either be required to repay the amount originally deducted or that the rebate would be discontinued in future". [34]

1.2 Hoffmann-La Roche[35]

<u>*facts*</u>

32. In *Hoffmann-La Roche*, most customers had subscribed to a non-compete *obligation* pursuant to which they would buy all or most of their vitamin requirements from Roche during a certain performance period (usually one year) and Roche had undertaken to pay them a rebate if they complied with this obligation. For some other customers it was doubtful whether they had firmly undertaken to buy all or most of their vitamin requirements from Roche. However, - as in *European Sugar Industry* - they would also receive a rebate if - in the year to come – they would place all or most of their orders with Roche.[36]

33. Again as in *European Sugar Industry*, Roche had calculated the rebate on the basis of total - rather than incremental – turnover. Moreover it was an "across-

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[33] §518 of the judgement.

[34] Ibidem, § 513.

[35] Commission decision, cit. footnote 4 and Court judgement, cit. footnote 2.

[36] Commission decision §§ 14-16 and ECJ judgement §§ 109-110.

the-board" rebate (*à la gamme* in the French version of the decision) based on the aggregate turnover for all vitamin groups bundled together.[37] An internal circular had stipulated that "this rebate will be cancelled entirely if the customer has not complied with the above principle for any single vitamin required by him and manufactured by Roche" (the "above principle" referring to the condition that customers order all or most of its requirements from Roche).[38]

34. We also learn that Roche had made value (or sometimes volume) estimates of each customer's purchase requirements for the year to come. These estimates gave Roche a tool to verify at the end of the year whether the customers had obtained all or most of their requirements from it and were entitled to the rebate.[39]

35. The rebates increased progressively as the customer's actual purchases got closer to the estimate. For instance, if the customer achieved 60% of Roche's estimate of its annual requirements, it got 1% rebate. If it managed to achieve 70% (= 16,6% more), the rebate went up to 1,5% (= 50% more), etc. [40]

assessment

36. In paragraphs 89 and 90 of its judgement, the Court confirms the Commission's view that Roche's rebate scheme infringes Art. 82. The grant of the rebate being "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", the scheme constitutes a "system of fidelity rebates".[41] The non-compete obligations or incentives are "not based on an economic transaction which justifies this burden or benefit but are designed to deprive the purchaser of

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[37] Commission decision, § 22-c.

[38] Ibidem, § 12.

[39]§ 97-1.

[40] §97-2.

[41] §89-2. Whether the rebate was a reward for customers who complied with an obligation to buy all or most of their requirements from it or whether it was a mere incentive for customers to buy all or most of their requirements from it, did not matter (see § 89-1 in combination with § 89-2).

or restrict his possible choices of sources of supply and to deny other producers access to the market".[42] The Court concludes that "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".[43]

37. The Court could have stopped there. However, in order to rebut Roche's argument that its rebates are lawful quantity rebates, it enters into an analysis of the specific contracts. It concludes that "although the contracts at issue contain elements 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, an examination of them (…) shows that they are in fact a specially worked out form of fidelity rebate."[44] In this context, the Court observes that "the undertaking by the purchaser to obtain supplies was drawn up in the form which placed him under the least constraint, namely that the purchaser was to obtain "most of his requirements" but that "the indeterminate nature of the undertaking thus worded is to a great extent offset by an *estimate* of annual requirements and by the granting of a rebate increasing in accordance with the percentage of the requirements which are met" (italics added) and hence that "this progressive rate is clearly a powerful incentive to obtain the maximum percentage of the said requirements from Roche".[45]

38. In paragraph 100 of its judgement, the Court concludes that "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

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[42] § 90-1

[43] § 90-2.

[44] § 98.

[45] § 99-2.

which it is sought to attain being not the maximum quantity but the maximum requirements" (italics added).[46]

39. It emerges from these excerpts that Roche monitored its customers' compliance with the explicit exclusive dealing arrangement by applying a volume target rebate system to each of them. This system comprised two features which are intimately linked. First, the system was customer-specific: Roche made an estimate of each customer's future purchase requirements ("estimates made, from case to case, for each customer"). Second, it was time-related ("according to the latter's presumed capacity of absorption"). The two features were intimately linked since Roche used the estimates of its customers' future purchase requirements during the given reference period to reward them in accordance with their actual purchase performance during this same reference period.

40. Since the *Roche* case concerns a target rebate system combined with an exclusive dealing arrangement, one cannot read into paragraph 100 of the judgement a outright prohibition of "stand-alone" target rebate systems, i.e. systems not used to monitor compliance with an explicit exclusive dealing arrangement.

41. Virtually all post-*Roche* cases will deal with the question when such systems create an incentive which is powerful enough to give rise– in their practical *modus operandi* – to concern under Art. 82. In *Roche*, there was no need for the Court to address this question.

42. Another issue naturally left open by *Roche* is whether a time-related rebate scheme which is not customer-specific can raise antitrust concern under Art. 82. Under such a standardised scheme, the dominant company links the rebates to uniform volume targets or - in *Roche* language - "quantities fixed objectively and applicable to all purchasers". However, whether this characteristic is sufficient to deprive the rebate systems of any fidelity enhancing force and thus to qualify them as lawful quantity rebate systems is another matter which will be adressed below.

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[46] §100.

43. Although the combination of an exclusive dealing arrangement with a customer-specific and time-related estimate of purchase requirements lies at the heart of the Commission's and Court's objections against Roche's rebate system, the Court identifies some additional features of the system which increased the customer's incentive to remain loyal.

44. First, since due to its progressive rate, the fidelity rebate exponentially grew with the incremental volume purchased by the customer, the Court noted that it gave the customer "… a powerful incentive to obtain the maximum percentage of the said requirements from Roche".[47]

45. Second, the "across-the-board" nature of the fidelity rebate (i.e. the fact that it was calculated on the basis of aggregate purchases of a range of vitamins belonging to different groups) meant that rival competitors supplying a smaller range of vitamins would find it very hard to offer a rebate that would compensate the customer for the loss of Roche's rebate.[48] Moreover, a customer would lose the entire rebate if it did not reach the value or volume targets for one or more of the vitamin groups. According to the Court, the rebate scheme therefore infringed Art. 82 (d) which prohibits tying, i.e. a practice whereby a dominant company conditions the sale of one or more products (the tied products) upon the sale of another product (the tying product).[49]

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[47] See § 99-2.

[48] Cf. § 110-2. See also Commission decision §12 quoting from an internal Roche document : « if a feed mill for instance is purchasing vitamin A, E, B2 Carfophyll, etc., even the most tempting offer from a competitor like BASF for vitamin A and E alone cannot induce the customer to change its supplier, because [it] would otherwise lose the fidelity rebate for Carophyll and for the vitamins BASF are not manufacturing".

[49] Thus the Court implicitly suggests is that each vitamin group operated in a way as a tying product for all the other vitamin groups since a customer who failed to meet the purchase target for one or more vitamin groups would lose the entire rebate. Cf. In 1996, *IRI/ACNielsen* (Annual Competition Report 1996, pp. 144-148) where the Commission issued a formal statement of objections against AC Nielsen concerning *inter alia* a discount given to customers who purchased Nielsen's retail track services in a considerable number of countries. Relying on *Hoffmann-La Roche*, the Commission qualified this as geographic tying. The subsequent Undertaking aimed essentially at unbundling the contracts covering more than one country.

1.3 Hilti[50]

facts

46. Hilti, a company trading in nail guns and their accessories (cartridge strips and nails) had taken a series of measures aimed at hindering further penetration of independent nail manufacturers into the market for Hilti-compatible nails. These measures included a rebate policy favouring customers who would not buy nails from these independent manufaturers. For instance, Hilti reduced rebates for customers who would order cartridge strips from it but no nails.[51] In addition, it granted an extra rebate to customers willing "to recognize brand loyalty with a family of products" although it "never stated publicly or to its customers that it operates this system or what criteria are involved for obtaining the supported status".[52]

assessment

47. *Hilti* is in essence a tying case in which nail guns and cartridge strips are the tying products and nails the tied products. The Commission needs few words to condemn the rebate practices. The policy to refuse rebates to customers who place "cartridge-only" orders is said to leave these customers with no choice over the source of their nails and to have the "object and effect of excluding independent nail makers".[53] The rebate policy favouring loyal customers is said to have "the same object".[54] In addition, the Commission stresses that Hilti simply informed the unsupported of a reduction in their rate of discount "without

[50] Commission decision, cit. footnote 4 and case T-30/89, *Hilti v. Commission*, (1991) ECR II-1439.

[51] See §§ 33-34.

[52] See §§ 42-43. Apart from offering rebates to its own customers, Hilti also singled out the main customers of its competitors and offered them special prices in order to attract their loyalty, "going in certain cases so far as to give away products free of charge" (§§45-47 and 80).

[53] § 75.

[54] § 83.

any attempt to explain the criteria on which the decision was based".[55] The Court could afford being even shorter in upholding the Commission's decision since Hilti had admitted that its behaviour would be liable to constitute an abuse if its dominance was established.[56]

1.4 British Plasterboard[57]

facts

48. Britsh Gypsum (BG) granted rebates to customers located in Great Britain as well as in Ireland and Northern Ireland on condition that they would buy all their purchase requirements from it rather than to import plasterboard from France and Spain.

49. In Great-Britain, BG made *monthly* payments to customers who remained loyal to it. In contrast with *Roche*, however, there is no evidence in the file that BG had made estimates of its customers' monthly purchase requirements and drawn up a scale of rebates which would increase with the volumes bought. The payments appeared to be more of a defensive move against increasing imports from France and Spain than part of a pro-active, well structured rebate scheme based on estimates of future purchase requirements.[58]

50. In Ireland and Northern Ireland, BG's rebates initially also supported price cuts merely designed to meet competition from France and Spain but BG began to give some thought to a more "positive action".[59] More than a year later, BG

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[55] § 82.

[56] See § 101 of the judgement. The Court also upheld the Commission's view that safety reasons did not constitute an objective justification for the practices (§§ 115-119).

[57] Commission decision, cit. footnote 4 and Case T-65/89, *BPB Industries and British Gypsum v. Commission* (1993) ECR II-389.

[58] §§ 58-69 of the Commission decision.

[59] Ibidem, § 87.

implemented a "quantity rebate" scheme for customers whose annual turnover in its products exceeded a certain level provided these customers would buy all their gypsum requirements (i.e. for plasterboard and other gypsum products) from it. The rebate was a percentage of all annual purchases and applied "across-the-board" to all gypsum products, not just plasterboard. [60] The case file does not give further details.

assessment

51. Relying generally on *Roche* but also on *Michelin I* (see below), the Commission condemns the British monthly rebates by observing that "in any event, the exclusivity arrangements meant that the merchants tied themselves to BG for the future" (italics added).[61] It does not explain how exactly these rebates would tie the customers "for the future" and the file does not enable us to provide this explanation. The fact that BG had asked the customers to spend the rebates for sales promotion purposes was not an excuse.[62] The Court confirms that it did not matter whether BG pursued several objectives (product exclusivity and sales promotion) by granting the rebates.[63]

52. As to the Irish "quantity rebates", the Commission notes that "BG was successful in inducing merchants concerned to stop importing and to agree not to import in future" and were therefore fidelity enhancing. No further explanation is provided as to how exactly these "quantity rebates" create loyalty "in future" (cf. monthly British rebates). The Commission also observes that these rebates "reinforced the exclusive ties between BG and merchants, for a merchant handling imported plasterboard would lose not only a rebate on plasterboard, but also on building

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[60] Ibidem, §§ 96 and 98.

[61] Ibidem, § 129.

[62] Ibidem, § 127.

[63] See § 71 (« even if it is conceded that one of the aims of that system might … have been to promote plaster products in general, it must nevertheless be stated that it leads to the grant of payments which are strictly conditional upon exclusive loyalty to BG").

plasters". This is reminiscent of *Roche* (tying).[64] While not specifically addressing the tying nature of the "across-the-board" rebates, the Court confirms the Commission's view that these rebates (like the British ones) were "conditional on exclusivity" and therefore unlawful.[65]

53. In our view, only the Irish "quantity rebate" scheme looks similar to the rebate systems condemned in the previous two cases *European Sugar Industry* and *Roche*. However, neither the Commission decision, nor the Court's judgement in this case add anything to the previous case law and the facts are too sketchy for any commentator to make such an effort.

54. A couple of years later, the Commission clears BG's rebate scheme called "Super Stockist Scheme" under Art. 81. This rebate scheme applies in principle to all customers whose annual purchases exceed a certain threshold. A Commission notice published pursuant to Art. 19-3 of Regulation n° 17/62[66] informs us that the scheme provides for a "standardized rebate" to be "applied within bands on the basis of projected turnover for the current year". While there would be "negotiation within these bands" between BG and the customer, this negotiation would be "based on objective criteria, to reflect different ways of customer trading and the level of promotion of BG's products". Furthermore "rebates would be applied to total projected purchases of plasterboard", not just to incremental purchases. While the reference period for these projected purchases is annual, the rebates themselves are "to be paid off invoice quarterly". Finally, BG would "not claw back any payment from a customer whose purchases fall below the projected levels during the year" but would "take such change into account in setting rebate levels in future years".

55. Although factual information on this scheme is extremely thin, it seems to fall within the third category of standardised volume rebate systems which will be commented below. In its twenty-second Annual Competition Report, the

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[64] Ibidem, §§ 148 and 152.

[65] § 120 of the judgement. The Court repeats that "it is of little importance (…) whether (…) the exclusive supply arrangements on which the benefit of the discounts at issue was conditional merely constituted one of several conditions imposed on the merchants"..

[66] O.J. C 321/9 of 08-12-1992

Commission provides no information about its assessment, apart from noting a) that the rebate scheme had undergone substantial changes compared to the one against which it had issued formal statement of objections and b) that BG's market share had dramatically fallen (from 96% to 65%) in barely two years and.[67] The latter point – as well as the fact that Art. 81 forms the legal basis for the clearance - suggests that the Commission had doubts about BG's dominance or about the potential foreclosure of this new system (or about both).

1.5 Solvay and ICI[68]

<u>*facts*</u>

56. The two cases have in common that the Commission challenges so-called "top-slice" or "marginal tonnage" rebate systems. Under these systems, Solvay and ICI – who were the dominant suppliers of soda ash in different geographic markets - had offered a rebate in order to induce their customers to buy exclusively from them the marginal tonnage which they might otherwise have purchased from a second supplier. This marginal tonnage came on top of the core tonnage which customers apparently bought from Solvay and ICI anyway.

57. As in *Roche*, Solvay and ICI had made estimates of their customers' annual purchase requirements. Whereas Roche had made these estimates in order to monitor its customers' loyalty for the entirety of their purchase requirements, Solvay and ICI had done it in order to determine the "trigger" tonnage for which loyalty would be rewarded. For instance, Solvay usually qualified 80% of these purchase requirements as core tonnage and the remaining part as marginal tonnage. As to ICI's estimates of its customers' requirements, the Commission observes – without further explanation - that "with this detailed knowledge (…)

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[67] Annex III at pp. 422-423.

[68] Commission decisions, cit. footnote 4. The Court of First Instance invalidated the Commission's decisions on procedural grounds : see cases T-32/91 (*Solvay*) ECR 1995 II-1825 and T-37/91 (*ICI*) ECR II-1901.

ICI was able to frame its top-slice rebate in such a way as to minimise the customer's purchases from any second supplier".[69]

58. The rebate itself was expressed as a percentage of the marginal tonnage sales (*Solvay*) or as a lump sum for each marginal tonne sold (*ICI*).

59. For the rest, Solvay's "top slice" rebate system operated under the different logic than ICI's "marginal tonnage" rebate system.

60. Solvay combined the "marginal tonnage" rebate with a substantial annual cheque payment "dependent upon the customer's obtaining all or most of its requirements from Solvay".[70] In other words, a customer purchasing marginal tonnage from a rival competitor would not only lose the "marginal tonnage" rebate but also the cheque payment. In its description of the facts, the Commission notes that Solvay could spread the cost of the marginal tonnage rebate and the cheque payment over the entire tonnage and that, as consequence, "the average price per tonne for Solvay across the whole tonnage supplied" was substantially higher than its net price for each marginal tonne.[71] The Commission concludes that "while the competitor has to offer this unprofitably low price on all the tonnage offered [by it], Solvay only has to do so on the last tranche".[72]

61. ICI simply used its "marginal tonnage" rebates to set its net price below the minimum-price which its main U.S. competitors had undertaken to offer in the context of an anti-dumping procedure.[73]

assessment

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[69] Ibidem, § 27-1.

[70] Ibidem.

[71] Ibidem. See also § 18 and §§ 20-23.

[72] Ibidem, § 17-2.

[73] See §§ 23-26 Commission decision.

62. Although the modalities of Solvay's and ICI's marginal tonnage rebates differed, the Commission challenges these rebates on roughly the same grounds. As in *British Plasterboard*, the Commission does not enter into great detail. It points at internal documents showing exclusionary intent.[74] In *Solvay* the Commission adds that the net price for a marginal tonne "is far below any economic price which the other Community producers could have offered".[75] This probably refers to the combined effect of the marginal tonnage rebate and the cheque payment which is conditional upon the customers purchasing all or most of their requirements, including their core tonnage, from it. In *ICI*, it was pretty obvious that the rebate which brought ICI's price under the minimum price at which the U.S. competitors had to sell their soda ash was effective in foreclosing business opportunities for them.

63. In both cases, the Commission also rejects the parties' argument that the rebates are cost-justified by observing that the rebate systems are customer-specific. It notes in particular that the "trigger" tonnage at which the top-slice rebate is activated varies from customer to customer.[76] This is in line with *Roche*.

1.6 Deutsche Post[77]

<u>*facts*</u>

64. According to its general sales conditions, Deutsche Post offered rebates to mail-order firms provided that they would be ready to "entrust all mail-order items

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[74] See § 52 in *Solvay* and § 55 in *ICI*.

[75] See § 53-2.

[76] See § 54-3 in *Solvay* and §§56 and 62 in *ICI*.

[77] Commission decision cit. footnote 4.

suitable for package and parcel post to [it]”.[78] Individual cooperation agreements incorporated this clause by making the rebates conditional upon customers’ sending all or a significant part of their items to DP.

65. At least one agreement (from November 1998) seemed to make the rebate (merely) conditional upon the customer reaching a certain annual volume without linking it to an exclusive dealing arrangement. The Commission stresses, however, that this is deceptive since “the minimum annual volume of […] million items is exactly […] % of the total volume sent by the customer ….” and “if the customer exceeds the minimum volume of […] million, a graduated rebate is granted, which rises to […]% if a volume of […] million (=100% requirements) is reached”.[79]

<u>*assessment*</u>

66. The Commission views all cooperation agreements as clear-cut examples of fidelity rebate schemes within the meaning of *Roche* since the rebates are “linked, not to a specific quantity, but exclusively to the requirements of the customer”.[80] It thereby lumps together the (large majority of) *Roche*-type of rebate systems (subject to exclusive dealing) and the target rebate from the November 1998 agreement “although the contract’s reference to a volume of […] million parcels at first sight is an element which appears to be of quantitative nature”.

67. The justification for this lumping together is made in a more general point up-front. Summarizing the Court’s distinction between fidelity rebates and quantity rebates and referring explicitly to similar language in the *Roche* judgement, the Commission states *inter alia*: “even where the fidelity rebate is linked to a specific quantity, it is given on the basis, not of that quantity, but of the assumption that the quantity represents an estimate of each customer’s presumed capacity of absorption, the rebate being linked, not to the largest possible quantity, but to the

[78] § 23.

[79] Ibidem, last indent but one.

[80] Ibidem, § 34.

largest possible percentage of the requirements".[81] In fact, singling out the customer-specific and time-related nature of the November 1998 target rebate system, the Commission suggests that there is no material difference between rebates explicitly linked to exclusive dealing arrangements and rebates linked to individualised volume targets. It does not expand on this point in conceptual terms. Nor does it add factual qualifications to it. This brings us to the next section which specifically deals with these individualised volume rebates.

SECTION 2 REBATES LINKED TO INDIVIDUALISED VOLUME TARGETS

2.1 Michelin I[82]

facts

68. On top of some transaction-based rebates, i.e. invoice discounts as well as cash discounts for payment before the due dates, Michelin had granted a variable discount conditional upon the customer's reaching certain annual sales targets for truck, van and car tyres.[83] In order to set these targets, Michelin – like Roche – had made estimates of each dealer's sales potential. The customer-specific targets for the upcoming year were usually higher than the amount of purchases made the previous year. The discount was expressed as a percentage of the customer's entire yearly turnover, not just the incremental turnover. Moreover, this turnover comprised all tyres, i.e. for trucks, vans or cars with no distinction of category (cf.

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[81] Ibidem, § 33 third indent.

[82] Commission decision, cit. footnote 4 and Case 322/81, *NV Nederlandse Banden-Industrie Michelin v. Commission*, (1983) ECR p. 3461.

[83] Initially, Michelin's rebate – like Roche's - was conditional upon the customer obtaining all or most of its requirements from it. This explicit exclusive dealing condition went under the name "température Michelin". Later on, Michelin dropped this condition although it continued to keep a record of its share in the dealers' total sales of tyres (see § 23 of the Decision).

Roche's "across-the-board" rebate scheme). Although the volume targets usually increased each year, the bonus tended to remain the same.[84]

69. The dealers did not know the criteria on the basis of which Michelin determined the bonuses and hence they did not know for certain how much rebate they could earn on sales of Michelin tyres in a given year. The only thing that Michelin discussed and agreed with them was the level of the annual volume targets to be reached.[85]

70. According to the Commission, Michelin had also granted dealers a once-only extra annual discount on their purchases of heavy tyres - when it was unable to meet demand for these tyres - on condition that they achieved a special target in purchases of light tyres. The Commission saw this as a tying of the sales of cars to those of heavy tyres (for which it was dominant). However, this objection failed on factual grounds and we therefore leave this point for what it is.[86]

Assessment

71. The Court starts off distinguishing Michelin's rebate scheme from Roche's discount scheme because it does not explicitly require dealers to purchase all or most of their requirements from Michelin. However, the Court discards from the outset Michelin's contention that its scheme therefore amounts to a lawful quantity rebate scheme. In this respect, it merely observes that the relevant volume was only an annual target and that this volume target "indicates only the limits within which the system applies".[87]

72. Since in the Court's view, Michelin's rebate scheme falls somewhere in between a (*per se*?) unlawful fidelity rebate scheme *à la Roche* and a lawful (though undefined) quantity discount, it concludes that it is "necessary to consider all the

[84] Commission decision, §§ 22-26 and ECJ judgement §§ 66-67.

[85] Commission decision, § 28 and ECJ judgement § 63.

[86] Commission decision § 27 and § 50 and ECJ judgement §§ 92-99.

[87] § 72.

circumstances, particularly the criteria and rules for the grant of the discount, and to investigate whether (…) the discount tends to remove or restrict the buyer's freedom to choose his sources of supply [and] to bar competitors from access to the market (…)".[88] Incidentally, the reference to "all the circumstances" is more cautious than the Commission's sweeping analogy between *Roche*-type of rebates and volume target rebates in *Deutsche Post* (see above § 67).

73. The Court then observes that "*any* system under which discounts are granted according to the quantities sold *during a relatively long reference period* 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 loss for the entire period" (italics added).[89]

74. This is the key passage of the judgement. We would like to distill three points from it.

75. First, a rebate scheme *can* be unlawful although the dominant company has not explicitly made payment of the rebate conditional upon the customer's obtaining all or most of its requirements from it. It suffices that the customer reaches certain individualised volume targets during a given reference period.

76. The *rationale* – though not spelled out – must be the following. The dominant firm bases the volume targets on its estimates of each customer's future purchase requirements. These estimates are based on the customer's past track record. Therefore the customer who meets (or exceeds) its volume target will maintain (or increase) the existing degree of loyalty towards the dominant company. Hence rebates set in function of this target *can be* fidelity enhancing.

77. Second, the Court highlights the time-related nature of Michelin's rebate scheme without explicitly referring to its customer-specific nature ("*any* system under which discounts are granted according to the quantities sold during a relatively

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[88] § 73.

[89] § 81. It added that "in this case the variations in the rate of discount over a year as a result of one last order, even a small one, affected the dealer's margin of profit on the whole year's sales of Michelin heavy-vehicle tyres" and that "in such circumstances, even quite slight variations might put dealers under appreciable pressure".

long reference period…"). What matters for the Court is that the buyer is under "increasing pressure" during the reference period, especially "at the end of that period", to reach the volume target in order to get the rebate.

78. 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 they 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.

79. However, since Michelin's volume targets were customer-specific, it would be unwise to extrapolate and conclude – solely on the basis of paragraph § 81 the judgement - that all time-related rebate schemes, including those containing uniform volume targets "fixed objectively and applicable to all customers", constitute unlawful fidelity rebate schemes.

80. Third, the Court does not explain why the relative length of the reference period matters. In *Michelin I*, the reference period happened to be a year. One may of course have the gut feeling that this is "relatively long". Moreover, Michelin initially paid a proportion of the annual discount every month and then every four months in the form of an advance. These advance payments were probably pretty effective in reminding the dealers of their interest to purchase Michelin tyres during the entire year. We submit, however, that there is no hard-and-fast rule according to which a given reference period of a year, a quarter or a month is long enough to render the rebate scheme unlawful. We will come back to this.

81. Before we move on to the post-*Michelin I* cases, we need to address briefly some additional points of relevance. As in *Roche,* the Court indeed identifies in *Michelin I* a few factors which add up to the restriction of the dealer's freedom of action and therefore to the barring of competitors' access to the market. First, the wide divergence between Michelin's market share and those of its main competitors (combined with the fact that Michelin's rebate was a percentage of

the dealer's total annual sales of heavy tyres) made it very difficult for any competitor to offer an attractive rebate because it would necessarily be a percentage of a much smaller turnover.[90] Second, the lack of transparency of Michelin's rebate scheme meant that "dealers were left in uncertainty and on the whole could not predict with any confidence the effect of attaining their targets or failing to do so".[91]

82. Like some specific features of Roche's rebate scheme (i.e. the across-the-board nature of the rebate system and the progressive rates of the rebate), these two factors are seen as accentuating the pressure on dealers to attain Michelin's sales targets.

83. It should finally be noted that the Court ends with a sweeping statement according to which "neither the wish to sell more nor the wish to spread the production moreevenly can justify such a restriction of the customer's freedom of choice and independence".[92]

2.2 Irish Sugar[93]

facts

84. In this case, the Commission condemns a series of pricing abuses, including two types of fidelity rebates which Irish Sugar and its distribution company SDL had granted to wholesalers reselling its product into the Irish retail market.

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[90] § 82.

[91] § 83.

[92] § 85.

[93] Commission decision, cit. footnote 4 and Court judgement, case T-228/97, *Irish Sugar v. Commission* (1999) ECR II-2969, § 198.

85. The first rebate appears to be a pretty straightforward one. In order to combat imports of 1kg packs of granulated Eurolux-branded sugar from a rival competitor in France (ASI), Irish Sugar *inter alia* offered its customer ADM a lower sales price for its own product. If ADM "were to reduce the amount of sugar purchased, this agreement would no longer be of effect".[94] Irish Sugar also went as far as to buy up quantities of ASI's sugar already supplied to ADM (and to swap its own product for that of ASI in the case of a retail customer).

86. The second rebate can be better compared with the type of rebate that was at stake in *Roche* and *Michelin I.* Between March and May 1994 and again for two weeks in October, Irish Sugar offered wholesalers target-based discounts on its Siucra 1kg brand if they achieved an increase on "previous average weekly purchases", to use the Commission's wording. The term "previous" referred to a six months reference period from April to September 1993.[95] Later on (end 1994), Irish Sugar also offered annual target rebates.[96]

<u>*assessment*</u>

87. The Commission concludes that the advantageous price under the first rebate scheme "was evidently not a normal quantity discount and represented a target or fidelity rebate that had the effect of tying a customer to the dominant supplier".[97] The Court confirms this without much ado. After having noted that the rebate "was not justified by the volume of ADM's sales but was determined by reference to sales *objectives*"[98] (italics added), the Court stresses that "SDL's approach to ADM took place in the context of a strategy devised (…) to prevent the expansion of the Eurolux brand on the Irish retail market by ensuring the fidelity of its

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[94] Commission decision (cit.) § 49. ADM would buy [X] tonnes of sugar and get this at [3X] tonne rate, which was – in the Commission's words – "a more advantageous rate".

[95] Commission decision, § 79 and § 81. See also § 151.

[96] Ibidem, §§82-84. See also § 151.

[97] Ibidem, § 127.

[98] CFI judgement (cit.) § 196.

customers, if necessary by exchanging competing products which they had acquired”.[99]

88. Relying on *Michelin I*, the Commission condemns the second rebate system because the rebates were “conditional on a company meeting particular targets that are *higher* than previous purchase amounts” (italics added).[100] The Commission specifies that “the fact that the rebates were dependent on meeting volume targets did not make them quantity discounts, which are normally unobjectionable”. It defines quantity discounts as being “normally paid in respect of *individual* orders (i.e. unrelated to the customer’s purchases over a period of time) and in return for cost savings achieved by the supplier” (italics added). It observes that “this is not the case with respect to the rebates which Irish Sugar has granted to certain customers on the basis of individual weekly, monthly or annual targets”. [101]

89. In sum, according to the Commission, customer-specific growth rebates based on a dominant company’s estimates of purchase requirements during a given reference period are unlawful, whatever the length of that reference period.

90. The Court upholds the Decision observing that “the Commission has not committed an error of assessment in taking the view that a rebate granted by an undertaking in a dominant position by reference to an *increase* in purchases made *over a certain period*, without that rebate being capable of being regarded as a normal quantity rebate *(point 153)* (…) constitutes an abuse of that dominant position, since such a practice can only be intended to tie the customers to which it is granted and place competitors in an unfavourable competitive position” (italics added).[102]

91. One will notice that the *Michelin I* qualification concerning the length of the reference period (“relatively long”) is no longer there. One way of reading this

[99] Ibidem, § 198. See also § 201.

[100] Ibidem § 152 .

[101] Ibidem, § 153.

[102] CFI judgement (cit.), § 213.

excerpt is therefore that the Court shares the Commission's view according to which the length of the reference period does not matter. In this logic, what matters is that the granting of the rebates depends on whether the customers manage to achieve certain volume targets during the reference period and not on the volumes purchased through "individual orders" – to paraphrase the Commission's statement in paragraph 153 of the Decision which the Court explicitly refers to.[103]

92. There is, however, another way of reading the Court's conclusion. Since it observes that the rebates are granted "with reference to an *increase* in purchases made over a certain period of time" (italics added), the Court might have taken the view that the rebate system at issue is particularly fidelity-enhancing because it only rewards growth. Such growth implies that the customers must do better than in the past, i.e. they must exceed the volume target which corresponds to volumes they have purchased in the past. Under this alternative way of reading the Court's statement, what matters is that customers who exceed the target not just maintain but increase the degree of loyalty towards the dominant company.

2.3 Virgin/British Airways[104]

<u>facts</u>

93. British Airways operated three commission schemes for UK-based travel agents which all rewarded these agents for meeting certain individualised volume targets during a reference period. Under the "marketing agreements" (MA) which covered tickets purchased in the United Kingdom, this reference period was a year. Under the "global agreements" (GA) which British Airways had concluded with three travel agents to reward their worldwide sales, the reference period was a year quarter (i.e. the 1992/1993 winter season). The "performance reward

[103] Commission decision, §153.

[104] Cit. footnote 5. The decision is *sub judice* (case T-219/99).

scheme" (PRS) covered again tickets purchased in the United Kingdom and used a reference period of a month.[105]

94. The volume targets were individualised. In other words, British Airways compared the travel agent's sales during the yearly, quarterly or monthly reference period with its sales in – respectively - the previous year (MA), the corresponding quarter in the previous year (GA) or the corresponding month of the previous year (PRS). Under the MAs the travel agents were forced to increase theirsales of BA tickets year on year.[106] Under the PRS, the performance benchmark was 95% of the BA-related turnover achieved in the corresponding month of the previous year.[107]

95. In all three cases, British Airways rewarded the customers meeting the volume targets with rebates which were calculated on the basis of these customers' total sales, not just on the basis of the incremental sales (i.e. sales exceeding the volume targets).[108] Under the PRS, a distinction was made. International and domestic tickets were rewarded separately. Customers received up to 3% on total sales of international tickets, but only up to 1% on total sales of domestic tickets if they met the volume targets. The volume targets themselves did not distinguish between the international and domestic tickets. Sales of these tickets were lumped together.[109]

__assessment__

96. In order to qualify BA's rebate schemes as exclusionary, the Commission observes that BA's rebate schemes are "very close in form to that condemned by the Court in the *Michelin I* case"[110] and that the *Hoffmann-La Roche* case

[105] See respectively §§ 10-15 (MAs), § 20 (GA) and §§ 24 (PRS).

[106] § 15.

[107] § 25.

[108] § 29.

[109] § 25.

[110] § 101.

"establishes that a system of discounts or rebates could have an equivalent effect to an exclusivity requirement in a supply contract and so be an abuse if practised by a dominant supplier".[111]

97. The Commission also observes that both cases "establish a general principle that a dominant supplier can give discounts that relate to efficiencies, for example discounts for large orders that allow the supplier to produce large batches of product, but cannot give discounts or incentives to encourage loyalty, that is for avoiding purchases from a competitor of the dominant company". It then discards BA's efficiency justification on the ground that "a travel agent that sells an inefficiently small number of tickets can earn the maximum commission provided its small sales represent a 25% increase over its sales in the previous year" and that "equally, a high volume travel agent will not get extra commission in return for the economies of scale it realises for BA unless its sales increase over the previous year".[112]

98. Without making it an element of its assessment, the Commission also explains in the factual part of its decision that BA calculated all its rebates on the basis of the customers' total (i.e. not just incremental) turnover during the reference period and that this constituted a particular handicap for rival competitors. It observes that "when a travel agent is close to one of the thresholds for an increase in commission rate, selling relatively few extra BA tickets can have a large effect on his commission income" and that "conversely, a competitor of BA who wishes to give a travel agent an incentive to divert some sales from BA to [it] will have to pay a much higher rate of commission than BA on all tickets sold by it to overcome this effect".[113]

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[111] § 99. See also § 97.

[112] § 101 and § 102.

[113] § 29. This is followed by a concrete example. This prompted the Court of First Instance to ask the Commission whether it is « altogether impossible that [the rival] competitor might be able to compensate for any loss of earnings on routes served by BA by a surplus of income on air routes served predominantly by that competitor or not served by BA or not falling within the geographical market identified by the Commission ».

99. This Decision also fits into the line set out by the Commission in *Irish Sugar*, a decision which was still *sub judice* when it adopted the *Virgin/BA* decision.[114]

100. First, the Commission does not consider the relative length of the reference periods to be an issue. As a matter of fact, it does not spend a word on it. It will be recalled that in *Irish Sugar* some reference periods were pretty short (weeks), that the Commission expressly contrasted the rebate systems at issue with (lawful) order-based quantity rebates and that the Court of First Instance upheld the Commission's position without referring to the relative length of the reference period.[115]

101. Second, the Commission rejects BA's efficiencies argument by insisting on the individualised nature of the volume targets. Under such a system, a small volume may yield high rebates and large volume may yield low (or no) rebates. It all depends on whether the customers have improved their individual "performance" towards the dominant company during the reference period. In other words, it depends on their degree of loyalty vis-à-vis that company.

2.4 Michelin II (in part)[116]

<u>*facts*</u>

102. The second Michelin case covers a wide range of rebate schemes. Apart from the Agreement for optimum use of Michelin truck tyres and the Agreement on business cooperation and assistance service (known as "the Michelin Friends Club") concluded with particular categoreis of dealers, reference must be made to

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[114] In *Irish Sugar* the CFI rendered its judgement on 7 October 1999, i.e. three months *after* the Commission adopted its decision in *Virgin/BA*.

[115] Cf. *Virgin/BA*, § 101 quoted above. As explained above, it is not clear how one should read the key passage in the *Irish Sugar* judgement. We have given two alternative readings. Either the CFI wished to suggest that the relative shortness of the reference period did not reduce the foreclosure problem. Or it wished to point out that growth rebates – as compared to other target rebates – increased the foreclosure problem.

[116] Cit. footnote 4. The decision is *sub judice* (case T-203/01).

the General price conditions for France for professional dealers. These price conditions comprised *inter alia* “quantity rebates” (*rappels quantitatifs*) – later replaced by the “invoice rebates – and “progress bonuses” (*primes de progrès*) – later replaced by “achieved target bonuses”.

103. These rebates, except the “quantity rebates” which will be commented upon in section 3 below, were based on individualised annual volume targets. The basis for a comparison between each customer’s past purchases and future purchase requirements was somewhat more flexible than in the cases dealt with so far. Dealers could indeed choose as their minimum “base” their purchases from the previous year or the average of the previous two or three years, whichever base was the more favourable one for them.[117] Michelin would only pay the rebates in the course of February of the year following the year of the purchases to be rewarded.[118]

assessment

104. The Commission challenges the legality of the “progress bonuses” formally on a triple ground: they are unfair, loyalty-enhancing and market-partitioning. In substance, however, the Commission objects to these bonuses on traditional *Michelin I* grounds. It is in essence the loyalty-enhancing nature of these rebates – especially towards the end of the year - which makes them objectionable in the eyes of the Commission.[119] There is no need to restate these grounds here.

105. As regards the “achieved target rebates” (which replaced the “progress bonuses”), the Commission not surprisingly adopts the same line of reasoning “as almost all the factors helping to increase the pressure on dealers under the progress bonus were in evidence here too”.[120] We just note in passing that the

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[117] § 260 for the progress bonus and §§ 84 and 86 for the invoice rebate.

[118] § 57.

[119] §§ 265-271.

[120] § 288.

Commission recycles *Michelin I* language when it observes that "it is inherent in any system of rebates granted on the basis of quantities sold during a *relatively long reference period* that pressure increases on the purchaser, at the end of the reference period, to achieve the level of purchases necessary for obtaining the rebate" (italics added).[121] The Commission seems to be peddling back here if one bears in mind *Irish Sugar* and *Virgin/British Airways* (where it did not consider the relative length of the reference periods to be an issue).

106. Finally, the Commission also describes the loyalty-enhancing nature of the "invoice rebates" (which replaced the standardised "quantity rebates", to be discussed later) in pretty classic terms.[122] We note in passing that according to the Commission, the individualised invoice rebates "appear to be *less* unfair and *less* loyalty-enhancing" (italics added) than the standardised quantity rebates because the dealers can choose the basis for comparison between their past purchases and future purchase requirements. This is an interesting observation since the prevailing view states the opposite, namely that standardised quantity rebates are – compared to individualised target rebates - less restrictive or not restrictive at all. We will come back to this.

SECTION 3 REBATES LINKED TO STANDARDISED VOLUME TARGETS

3.1 Michelin II (in part)

facts

107. As pointed out above, the so-called "quantity rebates" (*rappels quantitatifs*) in *Michelin II* differ from all other rebate schemes so far condemned in that they were based on standardised - not individualised - volume targets. Pursuant to

[121] § 287.

[122] §§ 282-285.

Michelin's grid, rebates were a percentage of the customers' annual turnover and increased with volumes purchased during the annual reference period. These target volumes were standardised, not based on estimates of each customer's purchase requirements. Incidentally, Michelin took total - not incremental - turnover as a calculation basis and it applied this criterion to all tyres (trucks, cars and vans). [123]

<u>*assessment*</u>

108. Before entering into the details, the Commission devotes one umbrella paragraph to the Court's *Michelin I* judgement and "more recent cases". [124] The Commission's interpretation of the settled case law since *Michelin I* is remarkable for a number of reasons.

109. First, the Commission does not explain why the settled case law since *Michelin I* provides a basis for challenging standardised – as opposed to individualised - rebate schemes. This is not to say that there is no good reason for challenging such rebate schemes (see below). However, it would have been preferable if the Commission had explained – with or without clear support in the established case law - why the difference between standardised and individualised rebate schemes does not matter.

110. Second, the Commission attributes to the settled case law since *Michelin I* a ruling "against the granting of quantity rebates by an undertaking in a dominant position where the rebates exceed a reasonable period of three months (as is the case here) on the grounds that such a practice is not in line with normal competition based on prices".[125] Yet, in *Michelin I* the Court of Justice only mentions a "relatively long reference period" (*in casu* – as in the present case –

[123] §§ 57-58 and § 216. Only heavy plant tyre and retreads categories each had their own grid (§58).

[124] § 216.

[125] Ibidem.

one year) whereas in *Irish Sugar* the Court of First Instance validates a Commission decision condemning target rebates some of which were linked to weekly dealer performances. The only instance in which the Commission has accepted a target rebate covering a reference period of three months was the Undertaking which the Coca Cola Export Corporation and its majority-held subsidiaries subscribed to in the *San Pelligrino* case back in 1989.[126] Whether one can determine the length of a reasonable reference period without looking at the facts in theconcrete cases at hand is another matter which will also be addressed below.

111. Third, the Commission attributes to the settled case law another point of principle for which there is no trace in any of the judgements: "in the Court's view, a rebate can only correspond to the economies of scale achieved by the firm as a result of the additional purchases which the consumers are induced to make".[127] It is true that all fidelity rebates condemned in the past were calculated on the basis of the dealers' total, rather than incremental, sales during the reference period. It is also true that equally efficient rivals might have a better chance to compete on the merits if the dominant company offers fidelity rebates which are calculated on the basis of the dealers' incremental turnover . However, it is quite a different matter to accept without further qualification or explanation that such rebates can be justified on economies of scale grounds (and to rely on the Court's authority to do so). Perhaps the Commission saw no need to qualify its statement in view of the fact that the *rappels quantitatifs* were based on the dealers' total sales. In any event, the statement contradicts the Commission's observation in *Irish Sugar* that lawful quantity rebates are "normally paid in respect of individual orders (i.e. unrelated to the customer's purchases over a period of time) and in return for cost savings achieved by the supplier".[128] This third point too will be addressed below.

[126] See press release IP (90)7 of 9 January 1990. The Undertaking does not require that the target rebates be based on standardised volumes or be limited to incremental sales of colas. Targets for a future year quarter were set on the basis of a comparison of sales in the corresponding quarter of the previous year (due to the seasonal consumption pattern).

[127] § 216 *in fine*.

[128] § 153 of the *Irish Sugar* decision.

112. Let us now move on to the Commission's more detailed reasoning. Like the individualised "progress rebates" with which they co-existed at the time, the standardised *rappels quantitatifs* are formally challenged on a triple ground: they are unfair, loyalty-inducing and market-partitioning.[129] However, as for the "progress rebates", the gist of the objections is that the rebates enhance the customers' loyalty and thereby foreclose business opportunities for rival competitors. In our reading, the Commission's reasoning falls apart in one key argument and a series of supplementary arguments.

113. With its key argument the Commission essentially paraphrases the Court's "increasing pressure" argument in *Michelin I*: "since the rebates applied to all of the Michelin turnover and were calculated only about one year after the start of the first purchases, it was not possible for dealers to know, before the very last orders had been placed, what the real unit purchase price of the tyres would be, which placed them in a situation of *uncertainty and insecurity*, prompting them to minimise their risks by purchasing mainly from Michelin" (italics added).[130] This argument focuses on the dealers' uncertainty with regard to their final average purchasing price of Michelin tyres.[131] A few comments are in place.

114. To begin with, although the Commission links this argument to the basis upon which the rebates are calculated (i.e. total turnover) and the length of the reference period (i.e. one year, later described as "long", "relatively long" or even "extremely long"[132]), it would seem to us that the uncertainty argument remains *conceptually* valid in cases where the rebates are based on incremental turnover and where the reference period is shorter than a year. Of course, the basis for calculating the rebate as well as the length of the reference period are parameters which – among others- are relevant when it comes to measuring how much

[129] §§ 218-247.

[130] See § 220. See also § 223 and § 239 : « what the Commission is challenging in the system of quantity rebates is the uncertainty in which the dealer is placed with regard to the reference framework used (the final total amount of sales of Michelin products over one year)…".

[131] See § 223 : « (dealers) were not able to base themselves on a reliable estimate of their cost prices and thus to determine their business strategy freely ».

[132] See respectively §§ 226, 228 and 229. In § 230 and in §§ 236-237, the Commission gives some concrete examples to illustrate how the "final (extra) order" could considerably affect the dealers' profit margin.

"uncertainty and insecurity" – and thus how much foreclosure – the rebate system at stake generates. However, it would have been helpful to distinguish the conceptual point from the practicalities of measuring the concrete foreclosure effects.

115. Furthermore, the Commission seems to take it for granted that the uncertainty argument applies just as much to standardised quantity rebates as it does to individualised ones. It would again have been helpful to openly say so and explain why. In our view, the point to make is that the dealers' uncertainty with regard to their average purchase costs exists as soon as the rebate is conditional upon their purchasing a certain aggregate volume in a series of transactions during a given period of time whereas it disappears when the rebate is granted and paid to customers in return for their purchasing a given volume in a single transaction. This will be developed below.

116. As to the Commission's supplementary arguments against Michelin's standardised rebates, two of them are reminiscent of *Michelin I*: the divergence between Michelin's and rival competitors' market shares and the lack of transparency of the rebate system.[133]

117. Two other supplementary arguments are now mentioned for the first time. One factor, namely the low dealer profit margins in the tyre sector, is seen as accentuating further the loyalty-enhancing nature of the rebates. This is an interesting point which is intimately linked to the key argument concerning the dealers' uncertainty about their purchasing costs. The Commission notes that the dealers' margins were indeed so low that "dealers were obliged to resell at a loss pending the payment of the rebates" and that "it was only when he was paid the various bonuses and premiums that the reseller recovered his costs and re-established his profit margin".[134] The other factor raises an intra-brand competition issue: since only purchases from Michelin France could be taken into

[133] See respectively § 241 and § 239. The lack of transparency, while not specifically applicable to the "quantity rebates", is said to apply to the general price conditions for France as a whole (to which these rebates belong).

[134] See § 218. See also similar language in §§ 222, 224 and 229 (where the quantity rebates are seen as «the only means of restoring the dealer's profit margin").

account, dealers had no incentive to use parallel trade channels to procure the tyres.[135]

PART III OPERATIONAL CONCLUSIONS FOR THE ASSESSMENT OF REBATE SYSTEMS OPERATED BY DOMINANT COMPANIES

118. A number of guiding principles emerge from the case law. For ease of reference we maintain the distinction between three types of rebate systems made in the previous section.

119. Rebates linked to exclusive dealing. When a dominant company grants rebates to dealers upon the explicit condition that they deal exclusively with it, such rebate systems are virtually prohibited *per se*. This is true when the exclusive dealing condition applies to "all or most" of the dealers' purchase requirements (see *ECJ Roche* and *COM Deutsche Post*) but it is equally true when the exclusive dealing condition has a narrower scope (see the "top slice" or "marginal tonnage" rebates in *COM Solvay* and *ICI*).

120. Rebates linked to individualised volume targets. A comparison of rebates serving as a *quid pro quo* for a certain degree of exclusive dealing during a given period and target rebates rewarding the purchase of certain individualised volumes during a given period shows that the latter have – what the Commission calls in *Virgin/BA* - an "equivalent effect" to the former. In both situations, the dominant company's estimates of its customers' future purchase requirements during a given reference period play a key role.

121. The Court highlights the role of these estimates in paragraph 100 of its judgement in *Roche* (for the first type of system) and the Commission describes this role in identical terms in *Deutsche Post* (for the second type of system which features in at least one of Deutsche Post's agreements).

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[135] §§ 242-247.

122. In fact, the explicit exclusive dealing *condition* in one system does not seem to matter since the calculation method in the other type of situation is bound to *encourage* exclusive dealing. The target rebates indeed encourage dealers to maintain – and, if possible – to increase whatever degree of loyalty they have shown towards the dominant company in the past. This is so because the targets are based on estimates of the dealers' future purchase requirements which are in turn based on their past track record during a period of equal length.

123. This *conceptual* point is pretty straightforward. However, it needs to be clearly distinguished from the next – and in practice decisive - question: in which circumstances will a particular target rebate system artificially raise entry barriers for the dominant company's competitors? It is not enough to point at some theoretical or entirely negligible potential foreclosure problem. This means that the litmus test for any target rebate system depends on the outcome of an evidentiary exercise. Or – as the Court put it in *Michelin I* - it is "necessary to consider all the circumstances".

124. The Commission has done so and the Courts have so far upheld all its Decisions. Yet, no one seems to see the wood for the trees anymore. In the perception of commentators, the Commission appears to be unclear and inconsistent. Lack of clarity is allegedly due to the fact that the Commission does not use a predictable checklist of parameters for assessing which target rebate systems are fidelity enhancing. The perceived inconsistency seems due to the way in which the Commission applies some of these parameters.

125. Take the length of the reference period. In paragraph 81 of its judgement in *Michelin I,* the Court suggests that only a "relatively long" reference period (*in casu* a year) can trigger the fidelity enhancing nature of the rebate system. Thereafter, one does not detect any consistency in the case law. Sometimes the relative length seems to matter, sometimes not.

126. In *San Pellegrino*, the Commission tolerates a target rebate for colas as long as the reference period does not exceed a year quarter. In *Michelin II* (where the reference period was a year as in *Michelin I*), the Commission quotes the

Michelin I language about “quantities sold during a relatively long reference period”.

127. In contrast, in *Irish Sugar* the Commission seems to disqualify the relative length of the reference period as irrelevant when it flatly contrasts “quantity rebates which are normally unobjectionable” because they are “normally paid in respect of individual orders” with “rebates which Irish Sugar has granted to certain customers on the basis of individual weekly, monthly or annual targets”. In *Virgin/British Airways* (where the reference period was one month), the Commission remains silent on the issue.

128. In our view, the existence of the reference period matters but it is impossible (and pointless) to try and determine its critical length in general terms.

129. Why does the *existence* of the reference period matter? Under individualised volume target rebate systems, a dominant company in fact bundles his customers’ sales transactions for a period of time with a view to comparing - at the end of that period - the volumes purchased with those purchased in a series of sales transactions during a corresponding past period. Due to this bundling, the customer will not know the average purchase price for each unit bought in the course of the reference period until at the end of this period (or even a bit later if payment takes place some time thereafter). 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 (see *ECJ Michelin I* or *COM Michelin II*). 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” (*ECJ Michelin I*).

130. It follows that 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 volumes which the customer has firmly committed to purchase in separate sales transactions, as the Commission suggests in *Irish Sugar*.[136] However, this is not to say that

[136] See § 153 of the Decision, referred to by the CFI in § 213 of its judgement.

unbundling is absolutely required in the concrete case at hand. This brings us to the next question.

131. Why does the *relative length* of the reference period matter? It matters because it is one of the parameters for assessing the degree of foreclosure caused by the particular target rebate system at issue. When does the relative length of the reference period become problematic? The answer is that there is no general answer. However, this does not mean that there is no predictable answer. In our view, it is helpful to look at the order cycles in the economic sector at hand. If customers tend to order their products – say – every two-three days, a one month reference period may be "relatively long" in *Michelin I* terms because a target rebate system based on this reference period bundles a substantial number of orders.

132. Can the relative length of a reference period automatically turn the target rebate system at issue into an unlawful one? No. Nor should it, however, automatically enable the dominant company to get off the hook. The assessment of the "bundling over time" must indeed be completed by an assessment of other relevant parameters (some of which we will list below). It will ultimately depend on the combined effect of these parameters whether the target rebate system at issue creates an appreciable foreclosure effect upon the dominant company's competitors. We therefore turn now to some other parameters which we have come across in the case law.

133. To start with, certain modalities of the rebate systems themselves provide supplementary parameters for the assessment. We confine ourselves to listing the most frequently mentioned ones: i) rebates are a percentage of total, rather than incremental, turnover (*European Sugar Industry, Solvay, Virgin/British Airways)*, ii) rebates are "across-the-board", i.e. conditional upon loyalty for a range of products (*Roche, Michelin I, British Plasterboard*), iii) rebates are progressive, i.e. they increase proportionately more than the purchased volumes (*Roche*), iv) the rebate system is opaque, i.e. the customers do not know how their loyalty will be rewarded (*Michelin I, Hilti*), v) the profit margins for dealers are low so that the rebates may make a big difference (*Michelin II*).

134. In addition, the objective market circumstances may further enhance the fidelity-enhancing effect of the rebate systems. One can refer in the first place to the divergence of market shares held by the dominant company and its rival competitors (*Michelin* I). One could add the product range of the dominant company's portfolio as compared to that of its competitors.

135. In some of its decisions, the Commission also stresses the cumulative fidelity enhancing effect of several co-existing rebate schemes. In *Michelin II*, the Commission had in mind rebate systems which – taken separately - were already unlawful: "over and above the fact that each of the elements making up the general conditions of sale constituted in its own right an abusive practice in several respects, it is important to note the extent to which the combination and interaction of the various conditions helped to reinforce their impact and thus the abusive nature of the system as a whole".[137] One could also imagine a target rebate system which might be lawful "on its face" but looses its innocence as it appears to be part of a broader web of unlawful fidelity-enhancing arrangements (cf. *Solvay* where the marginal tonnage rebate was combined with a substantial cheque payment *à la Roche*).

136. To end these reflections about individualised target rebate systems, we mention one issue on which the case law concerning systems linking the rebates to individualised volume targets is genuinely "settled". It is consistently held that such systems cannot be justified on economies of scale grounds. In this respect, it is systematically pointed out that small but loyal customers will always fare better than large but less loyal customers (e.g. *Solvay* and *ICI*). It is in fact the discriminatory nature of these rebate systems which enables Commission and Courts to reject out of hand the economies of scale justification.

137. For the rest, there is little or no case law concerning other possible objective justifications for fidelity enhancing rebate systems based on individualised volume targets. A safety argument was rejected in *Hilti* because there was a less restrictive alternative.[138] In *Michelin I*, the Court observes that better production

[137] See § 274.

[138] Cf. case T-30/89, (cit. fn. 50) §§ 115-119.

planning does not provide the dominant company with a justification for restricting its dealers' freedom of action.[139] In *British Plasterboard*, the Court noted that an unlawful rebate system does not become lawful simply because the dominant company tells the customer to spend the rebate for a purpose which is *in se* lawful (e.g. promotion).[140] In *European Sugar Industry*, the Court rejected the fact that Südzucker paid the rebate up-front (i.e. at the moment of invoicing the customers) as a possible justification.

138. <u>*Rebates linked to standardised volume targets*</u>. There is no established case law yet with regard to standardised rebate schemes based on a set of uniform volume levels such as the "quantity rebates" (*rappels quantitatifs*) condemned in *Michelin II*.

139. These systems have in common with those based on individualised volume targets that customers will receive rebates depending on the volumes they will buy from the dominant company in the course of a given reference period. Hence the rebates to be granted under such systems are also based on a bundling of sales transactions during that period and leave the customers in uncertainty over the exact net price of the products to be bought until the end of the reference period.[141] In other words, in *conceptual* terms there is nothing that separates these systems from the other two types of rebate systems. However, as with the individualised target rebate systems, when it comes to appraising the foreclosure potential it is necessary to consider all circumstances – to refer once more to *Michelin I*.

140. Under a system of standardised volume targets the customer's drive to maintain or increase its loyalty vis-à-vis the dominant company might perhaps be less outspoken than in a situation in which the dominant company determines the size of the "carrots" by comparing its future purchase requirements with its past track record. This might be so because individualised target rebate systems

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[139] See § 85.

[140] See § 127 Decision and § 71 Judgement. Cf. also *Roche*, § 96, cit. at footnote 19.

[141] Clearly customers will – due their size – only be directly and individually concerned by part of the rebate scale. Small customers will focus on the lower end of the scale and large customers will look at the upper end of the scale.

typically set challenging customer-specific volume *thresholds* below which no rebates are available at all. In contrast, standardised volume rebate systems do not contain such thresholds. They will typically comprise a high number of volume levels and corresponding rebates which may leave the customers with less uncertainty as to what their final average price for the purchased products. But this is a matter of degree. The uncertainty remains to some extent. In *Michelin II*, the Commission has decided that the uncertainty was important enough for the *rappels quantitatifs* to raise concern.

141. While the standardised rebate systems may therefore be fidelity-enhancing, the uniformity of the volume levels may give the dominant company a possibility to justify them with reference to economies of scale at the production level. At least, there is no manifest discrimination case to be made against a standardised system – in contrast with the individualised systems whose discriminatory nature made them ineligible for an efficiency defense.[142]

142. The dominant company would of course have to advance facts and figures to show that its conduct has led to verifiable efficiencies (see above § 22). Depending on which proportionality test it faces (see also § 22 above), the company would in addition have to demonstrate either that the size of its rebates is not "out of line" with the alleged savings stemming from the production efficiencies or that its conduct is the least restrictive means to achieve these production efficiencies.

143. The Court of First Instance might enlighten us soon since its judgement in *Michelin II* can be expected in the coming months.

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[142] As explained, the Commission qualifies the *rappels quantitatifs* inter alia as unfair but discrimination is not one of the factors the cumulative result of which is said to create the unfairness (§ 219). This is not to say that certain standardised systems may not – one way or the other – have discriminatory features.