

# CONDITONAL PRICING AND PREDATORY PRICING IN EUROPEAN ANTITRUST LAW

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## 1 The meaning of the rule.

In the European competition law, the term “competition” refers to both individual and social values; in the first context, the advantage of economic operators, representing a successful competitive struggle to be represented strictly as a kind of reward for effort, entrepreneurship, or involving a creative activity. The freedom to compete means the freedom of the consumer and their ability to choose freely. The competition also serves social interests, claims that the economic system is governed by consumer sovereignty, to the satisfaction of the social needs of the goods and services most appropriate.

In economic terms, a firm with market power implies the ability to raise price above the competitive level without losing sales in a way so fast that the price increase should not be profitable and must be rescinded. Market power has several degrees ranging from trivial market power of substantial market power or monopoly power; in antitrust cases, if we use the market power as a filter, the reference should be to a significant degree of market power.

The EU competition law has enacted its rules for the control of market power and protects the competitive structure and market dynamics, openness and access to markets and the right of its players to not be excluded by the strategies of firms with market power that are not based on competitive merit. The protection of this competitive process is considered adequate to preserve incentives to compete and serve both consumers and efficient market players.<sup>1</sup>

## 2 The structure of Article 102 of the Treaty on the Functioning of the European Union (TFEU)

The EU competition law has two basic and complementary objectives: the maintenance of effective competition in the European Union and the removal of barriers to the integration of the single market; the former is also called the "economic purpose" of competition policy, which involves maximizing economic welfare through the efficient use and distribution of scarce resources, and through the progress in the development of new production techniques or innovation and new products that make better use of those resources. The second is also called the "goal of integration" is a political objective of

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<sup>1</sup> Eleanor Fox. “Abuse of Dominance and Monopolisation: How to Protect Competition without Protecting Competitors”. In *European Competition Law Annual – What is an Abuse of a Dominant Position?* Claus Dieter Ehlermann, Isabela Atanasiou Editors. Portland 2006 p. 69 y ss.

vital importance: ensuring the integration of the economies of the Member States results in order to avoid internal barriers to trade within the community; companies must be willing to grow in their domestic markets and to operate on a more efficient scale across the European Union; when considering this objective, does not imply to pay attention to economic efficiency even in the case of behavior that seeks to limit trade across borders. If the impact of these behaviors on economic welfare is ignored, all decisions made only with respect to the objective of market integration may have perverse results.

In applying Article 102 TFEU, must be considered the conditions of competition in the market in which abuse has been committed; it comes from a functional concept whose content depends of the attributed abuse to the company, whose conduct has the purpose and effect to distort effective competition in the market.

The degree of control that holds the company involved in the market, and that allowed him to carry out an abuse under Article 102 TFEU, is determined through the relevant market; it means to determine the boundaries of competition between firms, and establish the framework within which the Commission applies competition policy; market definition from the point of view of the product and its geographical dimension helps to identify those potential of the undertakings that may limit their behavior or preventing them from behaving independently of any pressure that results from effective competition or actual competitors.

The definition of dominance used by the community doctrine and case law is found in the case *United Brands / Commission*, where the European Court of Justice (ECJ) has ruled that "the dominant position is a position of economic strength which holds a company that allows him to avoid the maintenance of effective competition in the relevant market, giving it the power to behave to an appreciable extent independently of competitors, customers and ultimately of its consumers. 2"

Here we found two aspects: a company can exercise its market power through decisions that affect the market demand conditions, for example: price discrimination; and second, the ability to assume strategic behavior in order to weaken, discourage or eliminate actual or potential rivals.

To establish the dominant position must go to the the doctrine and case law, performing complex analysis of the market, by which one should set both structural factors and behavioral factors, which must demonstrate that due to the existence of this firm in the market, the degree of competition is weakened.

One of the structural factors commonly used in the case law is the market share: the analysis of the market position of the dominant undertaking and its competitors. A second group of factors are the barriers to entry and barriers to expansion of competitors; it is necessary to determine if the market is closed by the presence of the barriers to entry, where there would be market power; however, the case law and doctrine, are not unanimous in identifying such barriers to entry.<sup>3</sup>

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2 Case 27/1976 of 26-6-1978. *United Brands Continental BV/Commission*. RJ 1978 p. 349. Para, 65

3 As for the meaning of a barrier to entry in European competition law, legal and economic theory, are closer to the definition of Stigler: 'the costs incurred by new entrants, but that are not made by those already in the industry' George J. Stigler. *The organization of industry*. 1983 Chicago. However, on the other spectrum one finds barriers to entry due to artificial distortions of the competitive process, assuming

The European Commission defines barriers to entry in the Guidance on the Commission's Enforcement Priorities in Applying Article 82 EC Treaty [actual 102 TFEU] to Abusive Exclusionary Conduct by Dominant Undertakings (the Commission Guidance)<sup>4</sup>, it says that an undertaking can be deterred from increasing prices if expansion or entry is likely, timely and sufficient. For the Commission to consider expansion or entry likely it must be sufficiently profitable for the competitor or entrant, taking into account factors such as the barriers to expansion or entry, the likely reactions of the allegedly dominant undertaking and other competitors, and the risks and costs of failure. For expansion or entry to be considered timely, it must be sufficiently swift to deter or defeat the exercise of substantial market power. For expansion or entry to be sufficient, it cannot be simply small-scale entry, for example into some market niche, but must be of such a magnitude as to be able to deter any attempt to increase prices by the putatively dominant undertaking in the relevant market.<sup>5</sup>

The Commission Guidance lists as barriers to entry the legal barriers, such as tariffs or quotas, or they may take the form of advantages specifically enjoyed by the dominant undertaking, such as economies of scale and scope, privileged access to essential inputs or natural resources, important technologies or an established distribution and sales network. They may also include costs and other impediments, for instance resulting from network effects, faced by customers in switching to a new supplier. The dominant undertaking's own conduct may also create barriers to entry, for example where it has made significant investments which entrants or competitors would have to match, or where it has concluded long term contracts with its customers that have appreciable foreclosing effects. Persistently high market shares may be indicative of the existence of barriers to entry and expansion.

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the definition of Bain, "the extent in which established firms in the market may raise their selling prices above average cost minimum of production and distribution, long-term without inducing access to the industry for potential entrants" Joe S. Bain. *Barriers to New Competition* 1956 Cambridge, Mass. Harvard University Press. Page. 3, barriers to entry are: the absolute advantages in terms of cost, economies of scale and product differentiation.

There is a consensus in the authors, including as barriers to entry: a legal standard as intellectual property rights; also the economies of scale and anti-competitive practices designed to discourage the entry in the market. Valentine Korah. "Concept of a Dominant Position Within the meaning of article 86." In *Common Market Law Review* N° 17, 1980. P. 395 and 403 C. W. Baden Fuller. "Article 86: Economic Analysis of the Existence of a Dominant Position" in *European Law Review*, 1991. P. 308-312 Paul A. Geroski and Joachim Schwlbach. "Barriers to entry and Intensity of Competition" in *European Markets 1992* Commission of the European Communities. Luxembourg. Richard Whish. "Competition Law" 3 Ed. Butterworths. London 2003 U.K. p. 264-268

After this agreement, some economists see as barriers to entry, the superior efficiency of a dominant firm, its technological know-how, the cost of advertising, product differentiation and the difficulty of gaining access to capital markets. However many of these issues have been questioned. In particular, under the definition of barrier to entry of Stigler, there would be some asymmetry between the position of firms already in the market and new entrants. The cost of advertising may not be a barrier to entry: the existing company had to invest in promoting his product and will face the new higher cost. Similarly, access to capital markets means an issue to the extent that the money markets are inefficient, but this is true also for any lender. By listing the barriers to entry into the European case law the authors dispute that some barriers are not as defined by Stigler.

<sup>4</sup> Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (OJ C 45/7, 24.2.2009)

<sup>5</sup> Commission Guidance, Ap. 16.

The Commission Guidance gives some lists of advantages that rivals can not replicate, which would be equivalent to an advantage over potential rivals. So it seems that the notion is closer to that of Stigler, however, the classification of barriers to entry, includes the sale and distribution networks, which under the definition of Stigler are not. In *Intel*, the Commission notes as barriers to entry arising from investment in marketing costs that necessarily involves high sunk costs or sunk investment that are associated to fixed costs such as research and development, marketing, and investment.<sup>6</sup>

With regard to Article 102 TFEU cases, the Courts has adopted a very broad criteria of barriers to entry, which has been criticized<sup>7</sup>, in the context of antitrust law, for some economists, they are broader than the meaning of economic theory, some barriers are not considered as such. The dilemma is articulated in cases where the issues will be characterized as barriers to entry when they are merely indicative of higher efficiency. "There seems to be no precise definition, and the current use a "barrier" seems to be something that makes it more difficult the entry for new firms in an industry."<sup>8</sup> For some authors, this tendency of courts means that Article 102 TFEU would have the paradoxical effect to discourage companies to compete on the merits, fearful of being considered dominant.<sup>9</sup> Others point out that is provided insufficient attention to the height of barriers to entry, or that the courts have considered as barriers, short-term factors that would not be considered by the economists<sup>10</sup>. However, a barrier to entry exists if the positive benefits persist in the long term.<sup>11</sup>

Another important factor is constituted by the constraints generated by the proper conduct of the dominant undertaking, for example, when it has made significant investments that entrants or competitors would have to match, or has concluded long-term contracts with its customers that generate effects appreciable annihilation, raising rivals' costs or discrimination among customers, are factors in the doctrine known as behavioral factors: evidence that the company has exercised its monopoly power in the market.

### 3 The Abuse of Dominant Position in the Market.

The wording of Article 102 TFEU is abusive exploitation by one or more undertakings in a dominant position, through the use of different methods of competition on the merits, established in the TFEU, produces consequences that are detrimental to the competitive process, which involves undue harm to consumers or other market participants.

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<sup>6</sup> Commission Decision 2009/05/13. Para. 867. COMP/C-3/37.990 *Intel Corporation*. DOCE C227/13, 2009/09/22

<sup>7</sup> Richard Whish. *Competition Law* 3 Ed. Butterworths. 2003. Londres U.K. p.264.

<sup>8</sup> Robert Bork. *The Antitrust Paradox: a Policy at War with itself* 1.978 New York: Basic Books. Pág. 90-91.

<sup>9</sup> Doris Hildebrand. *The Role of Economic Analysis in the EC Competition Rules*. Kluwer Law International. Londres. 2<sup>nd</sup>. Ed. 2002. p 48.

<sup>10</sup> Valentine Korah. *An introductory guide to EC Competition, Law and practice*. Ed. Sweet and Maxwell. Oxford 2007. P. 54.

<sup>11</sup> Luc Gyselen and Nicholas Kyriazis. "Article 86: the Monopoly Power Measurement Issue Revisited" in *European Law Review*. Vol 1. 1986, pp. 134. 138.

#### 4. Anticompetitive Abuse

A behavior is abusive for its anticompetitive effects when through the recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators has the effect of preventing the maintenance of the degree of competition still existing in the market or the growth of this competition. The lists of examples of Article 102 TFEU are examples of this behavior; they produce effects on the competitive structure.

In the European competition law, the effect on competition required depends on each case, where the competition it is weakened, caused by the conduct of the undertaking in a dominant position, which ultimately results in harm to consumer welfare.

The doctrine has proposed a series of tests to establish the abusive behavior; in the EU competition law, the behavior is analyzed on case by case basis, depending on the effects produced in the same market, where attention is paid to the protection of the two primary objectives: effective competition and integration.

In price-based abuses, the Commission Guidance applies the hypothetical equally efficient competitor test; for the other cases of abuse, effects depending on the particular type of behavioral approach based on established case law<sup>12</sup>.

#### 5. Price Abuses: Predatory Pricing

In practice, price discrimination between competitors can occur in two situations: first, when predatory prices in the broad sense, where the price is the problem; Second, when the parent company makes reductions in selling prices to their customers, ie, rebates and discounts granted on condition that the buyer purchases the dominant firm, all or most of their requirements of product in question. In this case, the illegality lies in the condition for which the price reduction is granted, and not on the price reduction itself.

The price is predatory when the firm is pricing below a particular measure of cost, the involved firm deliberately incurs in short-term losses in order to eliminate, discipline or discourage one or more of its actual or potential efficient competitors, so that in the future, and once achieved its purpose, it can set above competitive prices to recoup their losses, threatening the competitive process itself and thus causing harm to consumers.

For the purposes of Article 102 TFEU, the predatory pricing is built on two elements: (1) the ability of the company in a dominant position to deliberately incur losses, also called the sacrifice and (2) the anticompetitive exclusion.

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<sup>12</sup> Commission Guide, para 46.

European courts use the following to set predatory pricing: (a) The ability to raise prices by the company in a dominant position, evidence of predation must be feasible. (b) The proof of price-cost test in the short term: it is assumed that if the involved set their prices below average avoidable cost incurred losses and is therefore accredited predatory pricing; however, there are many reasons why the involved may incur in temporary losses without necessarily damage rivals. On the other hand, in EU case law, we see that the times during which predation occurred are too long: 4 to 7 years, assuming that this is an expensive strategy and it is difficult to plan, the analysis should be supplemented by other factors.

The Commission Guidance<sup>13</sup> applies the hypothetical equally efficient rival test: the Commission will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking; however, in some cases, the comparison is made with an opponent who does not necessarily be equally efficient.

It is praiseworthy that finally, in the American antitrust law and the in european competition law, there is an agreement in applying the equally efficient hypothetical test to predatory pricing, although in the first case, it is a safe harbor for companies that comparison in prices do with a hypothetical rival that is equally efficient in all cases.

Not part of the test is the element of recovery of loses, as the General Court noted in Wanadoo<sup>14</sup>. However, the recoupment of losses should be part of the test to demonstrate if the market structure facilitated predation, proving market concentration, barriers to entry and the ability to absorb the implied market share of the victim, otherwise, there would be harm to competition or consumers.

The Commission Guidance attaches importance to the strategic aspects of predatory pricing as reputation as a predator, predatory financing and predation by signs of obstruction of the necessary market information to victims, but only considers them as contributing to prove predation; this is an approach made by the economists of the Commission.<sup>15</sup>

The European case law permits the company in a dominant position can freely set their prices, except when they are below their fixed costs in the short term with the intention to eliminate one or more competitors, in which case even not admits to match their prices.

While the European court of justice have established more generally that if a dominant undertaking is attacked, could take decisions reasonable and proportionate to protect its own commercial interests; in *CEWAL* case established that there is abuse if a conference line in a dominant position selectively cuts its prices in order to match those of a competitor.<sup>16</sup> Faced with the question of whether the company can legitimately set

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<sup>13</sup> Commission Guide Ap. 22

<sup>14</sup> Ap. 110 – 111, Case C-202/07 of 2009-04-02 *France Télécom S.A. v/. Commission*

<sup>15</sup> Report by the EAGCP “An economic approach to Article 82”

July 2005 Jordi Gual et al. [http://ec.europa.eu/dgs/competition/economist/eagcp\\_july\\_21\\_05.pdf](http://ec.europa.eu/dgs/competition/economist/eagcp_july_21_05.pdf)  
accessed in september 18th 2014

<sup>16</sup> Cases C- 395-96O & C-396/96P, *Compagnie Maritime Belge Transports v. Commission*, “CEWAL”, [1998] para. 117

lower prices in order to compete with their rivals, the Commission and the General Court of the European Union (GCEU) in *Wanadoo*<sup>17</sup> have established that although it is not forbidden to align its prices with those of competitors, this option is permitted if it appears that it is not recovering the costs of the service in question. The company can not match the competitor, if their prices are below cost; the ECJ has confirmed that Wanadoo could not rely on an absolute right to align its prices on those of its competitors to justify their behavior when it constitutes an abuse of its dominant position.

When a rival is setting his price lower than the dominant firm, it may invoke the meeting competition defense only in the extent that its price level is not predatory pricing, ie below the average avoidable cost; in which case only apply if it is shown that the response is advisable, necessary and proportionate.<sup>18</sup> This requires that no other less anticompetitive means to minimize losses and the behavior is limited in time to the absolute minimum and not delay or significantly impede entry or expansion of competitors.

It seems that the Commission Guidance not expressly denied the opportunity to argue this defense, and the case law established in *Wanadoo* case, the defense to equalize competition is admissible only when it is established that the costs involved are above average avoidable cost.<sup>19</sup>

At the level of the costs, if the company sets its prices below the Average Avoidable Cost (AAC) this indicates that the company is sacrificing profits in the short term and an equally efficient competitor can not serve customers trying to capture without incurring a loss.

The failure to cover AAC implies that the company made a sacrifice of profits in the short term and that their competitors can not provide the intended customers get involved without incurring a loss.

Thus, in *AKZO*<sup>20</sup>, with the price below the average variable cost (AVC), the ECJ held: "A dominant undertaking has no interest in applying such prices except that of eliminating competitors so that it can allow subsequently raise their prices by taking advantage of their monopoly position since each sale generates a loss."

Then, when prices are above average avoidable cost, (AAC) or what the same, average variable cost AVC is but below the Long Run Average Incremental Cost (LRAIC)<sup>21</sup>

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<sup>17</sup> Case *Wanadoo* cit. para. 315

<sup>18</sup> Commission Guidance, ap. 28.

<sup>19</sup> For the meaning of cost levels see Commission Decision, footnote 18

<sup>20</sup> *AKZO* case, cit. para. 71

<sup>21</sup> See Commission Guidance, footnote 18: Average avoidable cost is the average of the costs that could have been avoided if the company had not produced a discrete amount of (extra) output, in this case the amount allegedly the subject of abusive conduct. In most cases, AAC and the average variable cost (AVC) will be the same, as it is often only variable costs that can be avoided. Long-run average incremental cost is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC and average total cost (ATC) are good proxies for each other, and are the same in the case of single product undertakings. If multi-product undertakings have economies of scope, LRAIC would be below ATC for each individual product, as true common costs are not taken into account in LRAIC. In the case of multiple products, any costs that could have been avoided by not producing a

means that the firm is not recovering all fixed costs (attributable) to produce the good or service in question and that an equally efficient competitor may be excluded.

The Commission Guidance states that the LRAIC is the same as the Average Total Cost for business users with single product, so that is somewhat similar to the test set by the ECJ in AKZO mode. To set the sacrifice by the firm, the Commission must establish that the involved fixed prices below average avoidable cost.<sup>22</sup>

The firm can invoke in his defense an objective justification for their behavior, in the sense that the conditions for an efficiency defense are met, this is the low price allows it to achieve economies of scale or efficiencies related to expanding the market and compensate any anticompetitive effects on consumers; however in European competition law, there are no cases where they were admitted.

## 6 Abuse in Prices: Conditional Pricing.

One of the most important different features between American antitrust law and the EU competition law is the approach taken towards illegal discounts or rebates; according to the first, these behaviors are not prohibited by Section 2 of the Sherman Act; however, for the second, they are by themselves abuse in Article 102 TFEU. However, in American antitrust law, in some circumstances, may be illegal; in this sense, there has been a great approach to the unification of criteria, but not quite.

### 6.1. Efficiency reasons of the conditional rebates:

-They reduce the production costs: in the case of single product discounts can benefit consumers by lowering prices and increasing production beyond fixing a monopoly, leading to a more efficient allocation of resources

-They permit efficient investment through loyalty rebates; the firm can recover a substantial investment in additional capacity that will be profitable only if the buyer agrees to purchase all its requirements of the manufacturer by an amount sufficient to recover its investment.

-Allows specific investments to supply a particular customer, the Commission Guidance<sup>23</sup> states that the discounts can be pro-competitive when a manufacturer in order to supply a particular client, makes an specific investment relationship, and to recover it may require the buyer to purchase a minimum amount of product that can be secured by a discount scheme.

-The exclusivity protects the investment of the seller from free-riding, prevents hackers imitators benefit from efforts to promote their brand<sup>24</sup>. The free riders are companies that consume more than equal to their share of resources invested, the free ride is that it

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particular product or range are not considered to be common costs. In situations where common costs are significant, they may have to be taken into account when assessing the ability to foreclose as efficient competitors.

<sup>22</sup> *Ibidem*, para 63

<sup>23</sup> Commission Guide, para. 46

<sup>24</sup> Ilya R. Segal y Michael D. Whinston. "Naked Exclución: Comment" in *The American Economic Review*, Marzo 2000, p. 296 y ss.

is not possible to establish the true demand curve and its benefit, and therefore can result in an inefficient allocation of resources.

-Encourages retailers to promote the product of his supplier: exclusivity promotes investment in the field of marketing, and therefore stimulates competition among brands. The market share discounts can be used by manufacturers to induce promotional efforts by retailers to allow consumers to take more informed purchasing decisions.

-Induce Retailer to increase their sales efforts.

## 6.2.Types:

Commission Guidance classifies two varieties of conditional rebates: the rebate being granted either on all purchases (retroactive rebates) or only on those made in excess of those required to achieve the threshold (incremental rebates).<sup>25</sup>

It is important to distinguish between different types of discounts. First, there can be standardized quantity discounts that are triggered once a buyer passes a certain quantity threshold. Among these there can be (i) discounts for the incremental units above a threshold; or (ii) discounts for all units once a threshold has been achieved, sometimes called 'first unit discounts' and sometimes 'retroactive discounts'. Second, there can be individualized discounts that are conditioned on the share of the requirements/needs of a buyer that are bought from the monopolist, or are conditioned on individualized quantities for each buyer. Again these discounts may be (i) for the incremental units above a threshold; or (ii) for all units (first unit or retroactive discounts). It should be clear that a discount on the share of the requirements of a buyer is an individualized discount because buyers generally have different requirements and it will apply at a different quantity for each buyer. Also note that a lump sum discount is a special case of an all- units discount.<sup>26</sup>

In *Intel* the GCEU<sup>27</sup> identified three rebate categories:

First: Pure quantity rebates, linked to the quantity of supply alone are "generally considered not to have the foreclosure effect prohibited by Article [102 TFEU]".

The court explained:

"[i]f increasing the quantity supplied results in lower costs for the supplier, the latter is entitled to pass on that reduction to the customer in the form of a more favourable tariff. Quantity rebates are therefore deemed to reflect gains in efficiency and economies of scale made by the undertaking in a dominant position."<sup>28</sup>

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<sup>25</sup> Commission Guidance Ap. 36

<sup>26</sup> Nicholas Economides, "Tying, bundling, and loyalty/requirement rebates" in Research Handbook of the Economics of Antitrust Law, Einer Elhauge Ed., Edward Elgar 2012, Page 132.

<sup>27</sup> Case T 286/09, 2014-06-12, Intel Corp. v/ Commission Para. 113. Intel has filed an appeal: Pending Case, Intel Corporation / Commission (C-413/14 P) (the *Intel* case), Paras. 72 to 94

<sup>28</sup> Ibidem, para.75

Volume discounts are presumed legal if the economic advantage to retailers is justified by the volume of business they bring or by any economies of scale that allows getting to the manufacturer<sup>29</sup>.

Second, exclusivity schemes are likely to be per se abusive, as they “are by their very nature capable of restricting competition”<sup>30</sup>. They are anticompetitive by object. Exclusivity-linked rebates in high market share lines will almost never be defensible. This is also true of schemes that link rebates to 75% to 80% or higher customer requirements. It does “not require proof of a capacity to restrict competition depending on the circumstances of the case”<sup>31</sup>. The GCUE found that exclusivity was the category at issue in *Intel*.

The court justified this strict approach by the fact of the company's dominance – competition is already fragile in markets where there are dominant incumbents – and the nature of an exclusivity scheme is such that it makes market access if not impossible, then substantially more difficult for competitors. The penalty for a customer breaching exclusivity is loss of the entire rebate. It loses not just the portion covering the rival's supplies, but also the quantities which the customer must continue to take from the dominant “unavoidable trading partner”<sup>32</sup>.

The discount is linked to the condition that the customer is supplied by the whole or a substantial part of the requirements of the company in a dominant position. They are incompatible with the objective of undistorted competition in the common market except for exceptional circumstances are not based on economic consideration justifying this limit or benefit, but aim to limit, the customer choice of their supply sources and they prevent to other producers their access to the market.<sup>33</sup>

For a dominant company, a rebate scheme linked to exclusivity is presumptively illegal. It is no defence to show that the scheme had little or no effect on competition, or that the schemes affected only a small proportion of the market. Similarly, it is irrelevant that the schemes were of short duration, were asked for by customers or that those customers were powerful buyers.

In the *Intel* case, the GCUE ruled that aspects such as the percentage of the rebate, coverage of this schemes and its duration, are irrelevant and do not need to demonstrate any potential exclusionary effect.<sup>34</sup>

Third category 'fidelity-building' rebates. The third category, by contrast, requires no case-by-case assessment; include those based on individualised targets, but without exclusivity or near exclusivity. In which case, it may be appropriate to consider an economic assessment of the kind advocated by Article 102, it is necessary to take in account their effects. In *Intel* the court was clear that the guidance's AEC test is not

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<sup>29</sup> Commission Decision *Michelin* Paras. 218-225. N°36.041 (2002/405/CE). DOCE L143/1 de 31.5.2002.

<sup>29</sup> *Ibidem* § 214 .

<sup>30</sup> Case 85/76. 1979-02-13. *Hoffman-La Roche & Co. A.G. v/. Commission*. RJ 1979 p. 459. Paras. 89 y 90 and Para 85 of the *Intel* case.

<sup>31</sup> *Intel* case Paras. 80 and 81

<sup>32</sup> *Intel* case Paras. 86 to 93

<sup>33</sup> Case *Hoffmann-La Roche c/ Comisión*, Para. 90, *Tomra c/ Comisión*, Case C549/10-P, para 210.

<sup>34</sup> *Intel* case, para. 113.

endorsed by case law; even in circumstances where that test has not been undertaken or has a positive result, it may still be possible to demonstrate that the scheme is capable of restricting competition.<sup>35</sup> It must consider "all the circumstances" of the scheme,<sup>36</sup> however, in the case law, the analysis of "all the circumstances" is poor.<sup>37</sup>

Other important factors include, the scheme's coverage, the rebate's affect on customers' finances, the strategic nature of customers, and the fragility of competition (are there new entrants or struggling rivals?); however, the broader strategic rationale and business documents surrounding the deal should not show illegitimate intent.

### 6.3. Illegality of discounts schemes.

Discount schemes can only have detrimental effects if eventually cause prices are higher than they would have been without the discounts; the probability of this long-term damage depends on whether and to what extent loyalty discounts: (a) reduce the price transparency; and / or (b) to exclude actual or potential competitors, creating / strengthening a dominant position, or possibly facilitate anticompetitive coordination.

The long-term damage by the dominant position, it is likely if all the following conditions are met: (i) Neither the existing rivals and new entrants can match the ability to compete by all or near all requirements of a significant number of buyers. (ii) The current competitors, if any, will be forced to reduce their sales; (iii) when the dominant company be subject to less restriction by competitors, it will find profitable to raise prices; (iv) Buyers can not use countervailing power to keep prices at or below prevailing level before the loyalty discounts are introduced; (v) The companies probably will not enter, re enter or expand their market shares in response to increases above the levels prior to discount; and (vi) What buyers initially gain through discounts is lower than the later lost through higher price.

Given the uncertainty about the likelihood and magnitude of net anticompetitive effects, seems guaranteed a case by case approach, to take into account all of the important differences in the structure of the fidelity discount and relevant market characteristics.

A loyalty discount may be illegal on the basis of predatory price; however, in *Intel*<sup>38</sup>, the GCUE has established that although in cases of predatory pricing, should make an analysis of prices and costs where it is impossible to assess the unfairness of a price without comparing it to other prices and costs: a price not it may be unlawful for himself. However, in the case of a discount for exclusivity, is the condition of exclusive or almost exclusive supply to which the grant is submitted, rather than the amount of the discount, which determines their unfairness.

*The fidelity condition generates loyalty exclusion effects in the rivals.* The General Court<sup>39</sup> considers that the following is factors demonstrate that the price is clearly not the predominant mechanism of exclusion of loyalty rebates.

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<sup>35</sup> *Intel* case, paras 144 and 145

<sup>36</sup> *Michelin I* case, para. 73

<sup>37</sup> See *Tomra* case, Para. 215 y ss.

<sup>38</sup> *Intel* case, para. 152.

<sup>39</sup> *Ibidem* para. 149

-The exclusivity condition that ties contestable and incontestable buyers demand in the same market. The dominant position has an externality, a barrier to meaningful entry, due to its product reputation, network effects, economies of scope, so that no supplier can satisfy the buyers demand without at least having the dominant firm products; for a large part of the market demand, there is no adequate substitute for the product supplied by the undertaking in a dominant position, it becomes an unavoidable trading partner.

-The rebates imply higher rivals costs, leading them to reduce output and raise the price; resulting in loss of economies of scale for efficient entry. Competitors may compete for a market share, but not the entire market. It limits the freedom of the buyer to acquire a rival product at a lower price. In the words of the case law, it must be demonstrated the effect that competitors can not get revenue quantities that may constitute a sufficient financial base to enable them to effectively establish a program of performance to reward customers, equal to the dominant position to counterattack the exclusionary effect<sup>40</sup>.

The CJUE in *Tomra* already pointed out that it is essential to examine whether a discount system requires an equally efficient competitor to charge negative prices, and even in the third type of discounts; a fortiori, it is not necessary in loyalty rebates.<sup>41</sup> On the other hand, competitors do not have effective and timely price strategies to compensate the customer for the loss of conditional rebate.

-The effect of uncertainty on clients, because they can not select another supplier because they do not know what will be the final amount that will match the discount, so that competitors aim to become second suppliers can not calculate the customer compensation for the loss of the discount<sup>42</sup>.

-The condition raises the switching costs of a substantial number of customers, thereby losing them considerable economic advantages obtained through the dominant firm discounts covering all or most all of their requirements applied in terms of long time and greater regularity.

*The as efficient competitor test.* The Commission Guidance proposes an analysis of prices/costs to determine the "effective price" of "contestable share". If the price is below the Average Avoidable Cost is likely anticompetitive exclusion. If the price is above the Long Run Average Incremental Cost, it is presumed no anticompetitive exclusion<sup>43</sup>. A version of the test was applied in the Intel case by the Commission.<sup>44</sup>

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<sup>40</sup> Commission Guidance, para. 38

<sup>41</sup> *Tomra* case, para 73, 74 y 80

<sup>42</sup> *Michelin* Decision, para. 46. *Michelin I* case, para 83. *Michelin II* case, para. 218-225

<sup>43</sup> Commission Guidance, para. 42 – 43.

<sup>44</sup> Commission Decision 2009-05-13. Case COMP/C-3/37.990 *Intel Corporation*. DOCE C227/13 de 2009-09-22 Para. 870

However, in the same case, the GCEU said that the test was neither necessary nor determining; the anticompetitive foreclosure could be present even when the company exceeds the test.<sup>45</sup> Since it found exclusivity alone was sufficient to found abuse, the court did not review the Commission's cost-based analysis. The allegations that this was erroneous were left unexamined.

One of the problems under the “as efficient competitor” test of illegality in fidelity rebates there is a need to protect some competitors that are not exactly equally efficient than the dominant position, this was assumed by the Commission, in the AEC test<sup>46</sup>

The criteria established by the Commission for the “effective price” and the “relevant range” parameters, are confusing and not easily administrable rules.<sup>47</sup>

First it should be analysed the pro-competitive potential of the discount schemes, where the price thresholds should not be part of the test; it must be established whether this behavior contributes to the dominant firm efficiency, or are intended to affect the rival efficiency, if so, proceed to balance exclusionary conduct with anticompetitive effects. Finally, it must be examined whether the dominant firm has a objective justification that would offset potentially anti competitive behavior.

In the case by case analysis of the pro and anti-competitive effects in the context of the market, should address the following elements:

(a)The structure of the scheme:

- The size of the discount, the greater discount, the greater incentive to buy from the dominant supplier.
- The length of the reference period creates switching costs for customers
- The increase in the discount rate, whether it is linear or steps and how much for each step
- The costs of substantial change in the client arising from the financial advantage which means the scheme, if the switching costs are substantial, so they are a barrier to entry, or create the exclusion of existing competitors, it should establish what are the exclusion

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<sup>45</sup> Ap. 151. *Intel* case.

<sup>46</sup> See Commission Guidance, footnote 23. “However, the Commission recognises that in certain circumstances a less efficient competitor may also exert a constraint which should be taken into account when considering whether a particular price-based conduct leads to anticompetitive foreclosure. The Commission will take a dynamic view of this constraint, given that in the absence of an abusive practice such a competitor may benefit from demand related advantages, such as network and learning effects, which will tend to enhance its efficiency.”

<sup>47</sup> See Commission Guidance, para. 40: In this context the Commission will estimate what price a rival would have to offer in order to compensate the customer for the loss of the conditional rebate if the latter would switch part of its demand (‘the relevant range’) away from the dominant undertaking. The *effective price* (emphasis added) that the rival will have to match is not the average price of the dominant undertaking, but the normal (list) price less the rebate it loses by switching, calculated over the relevant range of sales and in the relevant period of time. *The Commission will take into account the margin of error that may be caused by the uncertainties inherent in this kind of analysis.* (emphasis added)

effects that lead to anticompetitive harm through higher prices or actual reduction in consumer choice.

- If the total amount of the buyer purchases can be estimated in advance, or it could be increased significantly if the buyer actively traded enough (in the latter case, a target amount, it is legitimate incentive for effort).

- The lack of transparency of the scheme, if the amount was known by both parties to closely correspond to the total buyer requirements during the reference period.

- The speed of the falling price at marginal cost when it approaches to the acquisition of all of supplies.

- If the amount exceeds the total requirements of the buyer or seller of the product sales in the previous period, without any corresponding increase in the total demand of customers, especially if this occurs over several successive periods.

- If the amount that would lead to the reduction in price was known by the buyer during the reference period, so that was in uncertainty about whether or not reached it (ie, the transparency of the scheme)

- The customer requirements, this analysis should be considered static client demand for the products as well as a strong product brand.

- The range of products of the dominant firm acquired by the customer.

- If the buyer should buy some of its requirements from the dominant company because no other provider (in which case you are sure to acquire a cumulative rebate, it is sure to influence it), or it could buy all their requirements from the competitors who choose. If the customer should buy a large part of the requirements from the dominant firm, the cumulative effect of the reduction in sales above this fixed level is more likely to cause exclusion. The stability of the demand of the market share of the dominant firm and a strong brand would also be relevant. A company with a high and stable share market and a strong brand is more likely to cause exclusion through cumulative rebates.

(b) The market characteristics:

- Initial market power of the dominant firm. The divergence of the market shares compared to its competitors.

- The structure of the market demand. If demand is more or less finite, cumulative discounts tend to have the effect of shared customer requirements and will have direct impact on the opportunities for competitors. In contrast, if the demand is growing significantly or there is significant market opportunity for the product in question, a cumulative discount tend to have the effect of increasing market and then be less attributable to destroy competitors.

- Number and size of clients participating in the scheme, percentage of customers in the market benefiting from the scheme. The asymmetries that owns the dominant position compared to its rivals and the speed of market expansion.

- The network effects and the learning curve, depending on market characteristics.

- If this is a widespread market behavior by all competitors.

- The purchasing power of customers.

- The market share available to a potential entrant. What is the minimum efficient scale for entry, ie, the base cost for potential entrants, the minimum demand of the dominant firm in the absence of the scheme?

-The market share of excluded competitors as a result of the implementation of the scheme must be significant.

The meaning of the adopted analysis is explained by the main objectives of EU competition law are promoting a competitive market economy and prevention of barriers to market integration, which means that should be preserved opportunities for SMEs to compete on the merits and the rebates that promote loyalty among customers, can increase the market power of dominant firms because reduce transaction costs by not having to compete for future sales to the customer, thereby expanding its market share, giving the opportunity to exploit their market power, these statements must be considered on a detailed analysis of the behavior and its actual effects on the market context.

The balance is established between competitive advantage and anticompetitive harm the company should be allowed to show pro-competitive effects of the discount schemes that lead to lower prices in the short or medium term, if it allows for economies of scale in production, distribution, or if they lead to greater innovation and product quality, the consequences of the purchasing power of customers.

#### **6.4. The objective justification**

Justification on the basis of a defense of efficiency is not possible; the mere existence of a dominant position prevents the condition of no elimination of competition.

In the case law we found that the companies involved have argued that the behavior implemented was to respond to competition from other companies, however, in selectively low prices designed to respond to competitive offers, the Community courts have not accepted the argument, but considering that the discounts schemes are widespread practices in the market, the case law should provide a reason for denying the right to alignment involved in behavior recognized by case law in Akzo<sup>48</sup>.

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<sup>48</sup> AKZO case, para. 73