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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@portfoliomedia.com

Exclusionary Rebates: An EU Lack Of Progress Report

Law360, New York (March 10, 2010) -- For decades, EU competition law gave a seemingly simple answer to the question whether a dominant firm could grant rebates to its customers. Since the landmark Sugar judgment of 1975 and the 1979 Hoffmann-La Roche judgment, rebates that did not reflect pure cost-based efficiencies were held to be illegal because they allowed the dominant firm to restrict customer choice and make sure that they would retain a (near-)exclusive position.

Subsequent fining decisions of the EU Commission prohibited a number of rebates schemes implemented by dominant firms. Rebates were deemed abusive whenever they were not uniformly applied, linear rebates based on detailed cost justifications.

The Commission used “smoking guns” documents to prove exclusion, including documents of the dominant firm showing that rebates were aimed at maintaining or increasing sales, targeted at customers tempted to go over to competitors, or a response to competitors’ pricing initiatives. The Commission made no real attempt to determine whether competitors were unable to respond with comparable low prices.

This rigid approach was widely criticized not only for failing to provide dominant firms workable guidance, but also as affirmatively anti-competitive. A rule that requires all rebates to be based on precise cost justifications and be made available to all customers on uniform terms makes it less likely that a firm will offer any discounts at all, an outcome that is directly contrary to the fundamental purpose of the competition laws.

The European courts proved impervious to these criticisms. As late as March 2007, the Court of Justice held in British Airways that the Commission did not have to show that rebates had a concrete exclusionary impact on the market. All that was required to show that the conduct is abusive is that it tends to restrict competition, i.e. that it “is capable of having or likely to have such an effect.”

In the meantime, however, certain officials within the Commission’s Directorate General, Competition were increasingly, albeit generally in private, acknowledging discomfort with the court’s restrictive decisions and the lack of an economic framework to regulate the Commission’s interventions in this field.

In 2005, this debate was brought into the open by the publication of a Staff Discussion Paper on exclusionary abuses. The avowed intention was to bring a more economics-based approach to analyzing exclusionary abuses and to issue guidelines setting out the Commission’s thinking on how Article 82 EC (now Article 102 of the Treaty on the Functioning of the European Union) should be applied to this type of abuse.

In the event, the Commission proved unable to issue guidelines. Instead, in December 2008, it published a Guidance on its Enforcement Priorities in Applying Article [102 TFUE] to Abusive Exclusionary Conduct by Dominant Undertakings. The move from guidelines to a guidance document is more than a linguistics choice.

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Instead of stating the Commission's views as to how Article 102 TFUE should apply to alleged instances of exclusionary abuses, the Guidance describes the types of cases on which the Commission will concentrate its limited enforcement resources.

This matters because the Commission shares its enforcement duties with the Competition Authorities of the 27 Member States and also national courts who can issue cease and desist orders and grant damages for breach of Article 102 TFUE.

The Guidance does at times appear to support a dramatic departure from past practice. Thus, it heralds the Commission's intent to "focus on those types of conduct that are most harmful to consumers."

Responding to criticism, the Commission states that "what really matters is to protect an effective competitive process and not simply protecting competitors." The Guidance even concedes that a refusal to intervene may be appropriate even when that means "competitors who deliver less to consumers in terms of price, choice, quality and innovation will leave the market," a truly remarkable statement when compared to past enforcement practice.

As regards potential instances of pricing abuses and in particular rebates, the Guidance recognises that vigorous price competition is generally beneficial to consumers and that conditional rebates are a common practice, which may stimulate demand and benefit consumers.

The analysis of such pricing practices by dominant firms will focus on whether they have already hindered, or are capable of hindering, competitors that are as efficient as the dominant firm. To apply this test, the Guidance lays down cost-based thresholds: Prices above Long Range Average Incremental Costs will generally not warrant intervention, while prices below Average Avoidable Costs will generally indicate unlawful foreclosure.

So far, so good. Enthusiastic reviewers of the Guidance even posited that the Guidance introduced a safe harbour for all rebates that do not lead to prices below an appropriate measure of costs — which would be LRAIC or AAC depending on how aggressive the Commission wished to be. However, a closer look at the Guidance showed that such enthusiasm might very well have been premature.

First of all, applying the cost-based thresholds is in itself a complex exercise fraught with uncertainties. To name but a few: Whose costs should be used: the dominant firm's or that of competitors or even the constructed costs of a theoretical, efficient competitor?

After all, if a rule based on the dominant firm's costs can be applied by competition agencies with direct fact-finding and investigatory powers, the procedures of national courts in the EU rarely permit discovery, so the costs of the plaintiff may be the only information available to a court.

Also, when can less efficient firms be deemed worthy of protection? The Guidance suggests that relevant factors include network and learning-curve effects.

But Commission officials have mentioned, in speeches and discussions on the Guidance, that even an efficient new entrant may face lesser economies of scale for at least some period of time and that this should be taken into account in appropriate circumstances.

Once the source of the cost is identified and consideration is given to potential corrections to protect less efficient competitors, it is then necessary to identify what constitutes LRAIC or what costs are avoidable. That is no simple task, and enforcers may be inclined instead to apply the much simpler case-law of the European courts.

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But more fundamentally, the Guidance makes clear that the cost analysis described above does not happen in isolation. The Guidance sets out a general framework for analyzing foreclosure that applies to all instances of potential exclusionary abuse. This framework reintroduces into the analysis some of the criteria that were lent so much importance in past practice. That includes "direct evidence of any exclusionary strategy" — the smoking guns of old.

Given the considerable uncertainty inherent in the Guidance's status as a statement of enforcement priorities and in its open-ended language, the Commission's subjective attitude to dominant firms' rebates is crucial.

The signals from Brussels on this topic are not good. In 2006, the Commission issued a decision condemning the rebates applied by Tomra, the dominant supplier of reverse vending machines for retailers to take back beverage containers covered by a deposit scheme. This decision, adopted after the issuance of the Commission's Staff Discussion Paper, was heralded by many within the Commission as the dawn of a new age of more rigorous economic analysis.

Yet, a closer look showed that the core of the decision appeared to rest on the very same set of criteria as past decisions, including the use of smoking guns and the arbitrary definition of the contestable share of a customer's requirements, which the Commission has claimed is a central element for calculating the impact of rebates on competition.

In 2008, the Commission defended its old decision regarding the rebates granted by Solvay and ICI to their soda ash customers by arguing to the Court of First Instance that it was unnecessary for the Commission to prove the rebates' impact on competition.

In December 2009, the General Court of the EU (the CFI's new name) summarily rejected Solvay's appeal in case T-57/01, notably reproaching Solvay for not having brought forward evidence on its cost structure in the 1980's (the infringement period), without pausing to consider that the Commission, itself, should have gathered this information to prove its case.

In January 2010, the Commission stated to the General Court in the appeal brought by Tomra (case T-155/06) that the analysis it conducted in that decision went further than was required under the case-law. The Commission apparently even claimed to the court that dominant firms' rebates were bad news for customers.

Many observers awaited the Commission's decision regarding the Intel rebates, to see whether the Commission would apply the principles set out in its Guidance. In its May 2009 decision — which came six months after the Guidance – the Commission asserted legal reasons why the Guidance did not apply to the decision, although it claimed the decision was consistent with the Guidance.

As in the past, the Commission's Intel decision relies heavily on "smoking gun" documents. Based largely on statements in those documents, it concludes that Intel's rebates are illegal under the European courts' old case-law, before attempting any economic analysis.

It is only after having reached that conclusion that it examines Intel's rebates under a version of the as-efficient competitor test that departs on a number of points from the Guidance. The decision says, however, that this test, which is central in the Guidance's assessment of rebates, is not required under the law, but is just one way to demonstrate the exclusionary effect of conditional rebates.

The Commission's decision in Intel raises extraordinarily important issues regarding the application of the Commission's Guidance and other more modern methodologies against the backdrop of the courts' old case-law.

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The EU's General Court will have an opportunity to address these and other critical issues in the pending appeal of the Commission's decision.

With so much uncertainty and mixed messages from Brussels and Luxembourg, the Member States may be unlikely to embrace the Commission's Guidance. In a recent decision of December 2009, the new French Competition Authority, condemned a fidelity scheme applied by Orange Caraïbes on the basis of the European Courts' case-law. No reference is made to the Commission's Guidance, and no attempt at a cost-based analysis is made.

Arguably, public enforcement of the prohibition of exclusionary rebates in the EU is in a transition phase. Yet, unless the Commission jettisons its current "belt and suspenders" approach and brings its statements to the European courts into line with the modern, economics-based, policy it claims to be following, this phase may be long-lasting and may lead to the Guidance progressively losing, rather than gaining, influence.

--By Frédéric Louis, WilmerHale

Frédéric Louis is a partner with WilmerHale in the firm's Brussels office.

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