The Antitrust Treatment
of Loyalty Discounts and Rebates
in the EU Competition Law:
in Search of an Economic Approach
and a Theory of Consumer Harm

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Authorship Declaration

I hereby declare and confirm that this thesis is entirely the result of my own work except where otherwise indicated. I acknowledge the supervision and guidance I have received from Prof. Dr. Thomas Eger. This thesis is not used as part of any other examination and has not yet been published.

(Word Count - Sections 1-5.3: 14.859)

15th August 2011

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«Where did we come from? Where are we going? Is there possibility of a group discount?»

Woody Allen

1. The Definition of Loyalty Discounts and Rebates

In general terms, loyalty discounts and rebates may be defined as a reduction in the list price of a relevant product which a seller or supplier offers to a buyer or distributor as an explicit or implicit reward in exchange for a relationship of substantial exclusivity. As a result, the key difference respect to the standard form of price discounting is that a loyalty scheme is structured such as, on one side, to provide significant benefits to the customer in case it maintains or raises its purchasing expenditure towards a particular supplier, and, on the other side, to impose heavy penalties to the customer in case it switches its purchasing expenditure towards a rival supplier. In fact, since in common practice the supplier does not usually grant the price premium to the customer if it moves even only a limited part of its purchasing requirements to another competitor, the two types of loyalty structure may entail an effect similar to an exclusive dealing, which as known forces the customer to purchase the entire or significant part of its total spend from a specific supplier.

Nevertheless, as demonstrated by the fact that these practices result extremely frequent in the market relations, loyalty discounts and rebates are normally not problematic. If competitors are able to compete on equal terms against rivals and if customers are able to respond actively to the incentives proposed, loyalty schemes are unlikely to be anti-competitive and instead may represent pro-competitive instruments in support of a price competition regime, which in turn may increase the general level of social welfare. On the contrary, in the presence of a dominant firm, loyalty structures may cause crucial problems from a competition policy perspective. Within this context, the present work is therefore intended to develop a critical and extensive economic analysis of the issue, in the light of the latest guidelines on abuse of dominant position published by the European Commission and the most recent EU case-law in regard.

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Although in common language a distinction between the concepts of discount and rebate appears often absent, the main characteristic shared is that the granting of both is conditional on the achievement of a certain amount of purchases within a given reference period, whereas the main difference is that for the former the premium is applied directly to the list price and for the latter the premium is awarded indirectly in a rebate cheque. However, even if in the presence of a dominant undertaking it is not sufficient to examine the form of the discount or rebate in order to carry out a correct evaluation of its loyalty effect from an antitrust standpoint\(^1\) (as it will be demonstrated in the next section), as a preliminary matter, it is necessary to consider how the structure of a generic discount or rebate may change in terms of three primary features\(^2\).

Firstly, according to the type of threshold, it is possible to distinguish between fidelity and target discounts and rebates. In the first case, the threshold set by the supplier that the customer must achieve is defined by a percentage of growth in the customer’s purchasing expenditure calculated in comparison with a past period (growth discount or rebate), by a percentage of the customer’s purchasing requirements (market share discount or rebate) or by an exclusivity obligation (exclusive discount or rebate). In the second case, the threshold set by the supplier that the customer must reach is defined by an individualized or standardized volume of units (quantity discount or rebate). Nonetheless, in the common experience, as in case of fidelity discounts and rebates, also for the target category, or at least for the individualized variant, which generates more problems from a competition law point of view (as it will be shown in the next section), the threshold is typically set such as to correspond to the entire or significant part of the customer’s demand. Thus, the two loyalty schemes tend to produce substantially the same economic effects.

Secondly, according to the scope of application, it is possible to distinguish between incremental discounts and rebates, which are applied forward-looking, i.e. only on the additional units purchased above the threshold (prospective discount or rebate), and retroactive discounts and rebates, which are applied backward-looking, i.e. not only on the additional units purchased above the threshold, but also on the previous units purchased below the threshold (all-unit, back to one, roll-back discount or rebate).

Thirdly, according to the scope of products, it is possible to distinguish between single item discounts and rebates, which are applied to the units of a single product acquired (single-product discount or rebate), and bundled discounts and rebates, which are applied to the units of a range of products acquired (multi-product discount or rebate).

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As regards its methodological setting, the current economic assessment is primarily focused on the discounting practice which emerges in the form of a single-product retroactive rebate for three principal reasons: in the first instance, it constitutes one of the most frequent agreement adopted in commercial transactions, which however if employed by a dominant firm is expected to be deemed as illegal per se, as demonstrated by all the judgements delivered until now in the Community case-law and the severe scrutiny reserved by the national competition authorities; in the second instance, it represents a topic that remains particularly unexplored, as proved by the limited number of academic papers that has been published in the light of the new effects-based approach issued by the Commission and the controversial cases recently examined at EU level; in the third instance, the present work does not significantly alter the conclusions that may be drawn for the other less relevant types of loyalty discounts and rebates.

2. The Economic Analysis of Loyalty Discounts and Rebates

A rebate may be defined as retroactive whether, as mentioned in the previous section, the customer obtains the discount on all the quantities acquired, after having reached a certain amount of purchases within a given reference period. As a result, the discount is applied retroactively to all the previous purchases made by the customer before the purchasing target has been reached and not exclusively to the purchases realized above the threshold, as in case of incremental rebates. Hence, in case of retroactive rebates, the purchasing target corresponds to the quantity of units that, if it is acquired by the customer before the expiry of the reference period, triggers retroactively the discount on all the previous purchases. In most cases, the main advantage of using a retroactive rebate rather than an incremental rebate, which in turn justifies its higher frequency, is that the former allows to adopt more easily than the latter a price discrimination scheme through which large customers pay a lower price while small customers pay a higher price, as a recompense of the different level of loyalty shown.

However, in case of retroactive rebates, because the discount affects retroactively the total amount of units purchased in the reference period, the customer is subject to a so-called “lock-in effect” in the form of a switching cost. In fact, if the customer chooses to change its supply source, it risks to not reach the threshold, losing the discount otherwise determined on all the previous purchases already realized in the reference period. Given that the supplier is generally able to define an individualised rather than a standardised purchasing target that reflects the buyer’s total requirements, the customer would be less likely to switch to other suppliers, since it would be more complex for it to cross the threshold within the reference period.

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In addition to the loyalty-enhancing effect, retroactive rebates raise a further problem, i.e. the so-called “suction effect”, which is identified in proximity of the purchasing target. In fact, once the customer has reached an amount of purchases that is very close to the threshold, only a slight increase in the quantity of units acquired would be enough to trigger retroactively the discount on all the previous purchases. Thus, the incremental price, which a customer must implicitly correspond for the marginal units necessary to achieve the threshold, may be inferior to the discounted and list price (cf. Formula 1)\(^4\). Furthermore, given the non linear and retroactive nature of the rebate, the total expenditure borne by the customer faces a discontinuity in correspondence of the threshold. In fact, if the purchasing target is reached, the total expenditure may decrease to a level lower than the one prior to the achievement of the threshold. As a result, in relation to the incremental price, it is possible to state that: firstly, it may be below cost or negative, even tough the average discounted price may be not predatory (cf. Example 1)\(^5\); secondly, it decreases as the discount rate, the marginal and the total units necessary to reach the threshold increase (cf. Figure 1)\(^6\).

**Formula 1 - Mathematical Formula for the Incremental Price**

\[
P^I = \frac{P^L [ X_m - (r \times X_t) ]}{X_m}
\]

- \(P^I\) = incremental price
- \(P^L\) = list price
- \(r\) = discount rate
- \(X_m\) = marginal units necessary to reach the threshold
- \(X_t\) = total units necessary to reach the threshold

**Example 1 - Incremental Price and Predatory Price**

The firm sells to the customer an unit of product, whose average cost is of 0,90€, at a list price of 1€. Furthermore, the firm grants a retroactive rebate of 5% if the customer reaches a volume threshold of 1,000 units. Thus, if the customer increases the amount of units purchased from 999 to 1000, the total expenditure decreases from 999€ to 950€, which in turn implies that the incremental price calculated on the last unit is negative (applying the analytical formula above shown: 1 \( [ 1 - (5\% \times 1000) ] / 1 = -49\)), although the final and total average discounted price, which is equal to 0,95€ (950€/1000 units), results not predatory, being higher than the average cost of 0,90€.

In relation to the reference period, the switching cost due to the suction effect is moderately low in the starting phase and extremely high in the ending phase, during which it may lead to a negative incremental price (cf. Example 2)\(^7\). In the extreme case where the purchasing target is defined by the supplier at a level superior to the real customer’s requirements, the suction effect may result even more aggravated, since it would push the customer to acquire a quantity of units that neither needs nor would purchase in the absence


of the retroactive rebate. In conclusion, the present section has therefore demonstrated from an economic perspective how the suction effect at the base of a retroactive scheme may potentially generate a reduction in the contestable portion of the demand, which in turn, if a dominant firm is involved, may entail an anti-competitive foreclosure on actual or potential competitors, as it will be further explained in the next section.

Figure 1 - Incremental Price and Suction Effect

Figure 1 illustrates the suction effect related to a retroactive rebate which presents the following characteristics: 1. discount rate ranging from 0% to 50%; 2. normalized price base of 1; 3. volume threshold of 10,000 units. The area squared represents the price a competitor must match in order to leave the customer indifferent between its offer and the retroactive rebate proposed by the rival firm. As shown, the price the competitor must match decreases as the discount rate offered and the level of sales made by the rival firm increase, becoming negative when it falls below the solid colour plan.

Example 2 - Incremental Price and Reference Period

The firm sells to the customer an unit of product at a list price of 100€. Furthermore, the firm grants to the customer a retroactive rebate of 5% if the customer reaches an annual threshold of 1,000 units. At the same time, the customer is willing to purchase 500 units from a new entrant. However, if the customer purchases 500 units from the new entrant, it would not be able to reach the purchasing target set by the incumbent firm. Therefore, what should be the price the rival firm must offer to the customer to compensate it of switching part of its sales? The rival firm should return to the customer the total discount lost from the incumbent firm, that is equal to 5,000€ (discount rate applied to the total sales made at the list price: 5% of 100€×1,000). Nevertheless, the discount rate the rival firm should offer to the customer depends on the quantity of units over which it can recover and spread the total discount, which in turn depends on the period of the year during which the rival firm is able to convince the customer to switch. Assuming that the customer purchases on average the same quantity of units each month, it follows that: during the first month (500 units available - 1/12 of 500), the rival firm would need to compensate the total discount of 5,000€ offering an unit discount of 10€ (5,000€/500), which is equal to a discount rate of 10% (10€/100€); at half year (250 units available - 6/12 of 500), the rival firm would need to compensate the total discount of 5,000€ offering an unit discount of 20€ (5,000€/250), which is equal to a discount rate of 20% (20€/100€); during the last month (42 units available - 1/12 of 500 units available), the rival firm would need to compensate the total discount of 5,000€ offering an unit discount of 119€ (5,000€/250), which is equal to a discount rate of 119% (119€/100€). It is important to note that in proximity of the end of the reference period the rival firm is induced to offer a negative price and thus to incur a loss, being the net price (-19) equal to difference between the list price of 100€ and the unit discount of 119€.

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3. The Guidance Paper on the Application of Article 102 of the TFEU

In the Guidance Paper on the application of Article 102 of the Treaty on the Functioning of the European Union (TFEU), whereby the European Commission provides essential guidelines to apply an effects-based analysis to exclusionary abuses, in relation to the loyalty schemes it has been developed an As-Efficient-Competitor test for evaluating whether a rebate structure granted by a dominant undertaking presents actual or potential foreclosure effects. After the further confirmation of a per se prohibition against dominant firm’s retroactive rebates established in the renowned cases British Airways and Michelin II, a significant number of academic commentators has started to show that, despite the loss of a complete but imperfect legal certainty, an economic approach was definitely more suitable to correctly implement an antitrust assessment of the commercial practice at issue, especially considering its potential efficiencies and its regular use in all the industrial sectors. In fact, if a retroactive rebate causes only a minimal and negligible exclusionary impact, a form-based rule would impede behaviours beneficial for the competitive process, such as, for instance, elimination of double marginalization, prevention of free-riding and recoupment of fixed costs of production.

Accordingly, the Commission states in its enforcement guidelines that the anti-competitive nature of a conduct can be deduced without carrying out a detailed examination only if the practice generates no efficiencies and hampers competition (Guidance Paper, paragraph 22). In particular, following intense discussion preceding its publication, for the evaluation of discount structures the enforcement guidance has proposed a variant of the predation test. In a nutshell, the price-cost test designed at EU level consists of a two-phase model, which basically aims to verify if an equally efficient competitor would be able to contest the price resulting from the application of a rebate scheme by a dominant firm, persuading the customer involved to renounce to the economic conditions proposed by the latter.

In general terms, it is important to underline that the Commission in its recent guidelines, although it remains rather careful in the assessment of conditional rebates, at the same time makes a significant breakthrough towards the adoption of a real economic approach. In fact, on one side, it affirms that a discount system may produce foreclosure effects comparable to those produced by exclusive purchasing obligations, even without resulting in a profit sacrifice, as well as it asserts that a dominant firm may monopolistically exploit the non-contestable share of the customer’s demand as leverage to reduce the price on the contestable share, increasing its total profits (Guidance Paper, respectively paragraphs 37 and 39).

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On the other side, it admits that it is matter of fact that loyalty and suction effects are maximum in proximity of the threshold. In practical terms, in fact, the mere existence of volumes of product sold at a very low discounted price, which in turn might be the result of a negative incremental price, does not constitute sufficient condition (as happened in the two above mentioned cases) to declare that an equally or even more efficient competitor would be subject to an anti-competitive foreclosure. On the contrary, it is necessary to realize a complete assessment of the impact of the dominant firm’s rebate system, in order to ascertain if there is the risk of an exclusionary effect on actual or potential competitors (Guidance Paper, paragraph 40).

Furthermore, the Commission correctly emphasizes that the evaluation of a rebate structure strongly depends on the nature of the threshold, which may be individualized or standardized. As in case of exclusive purchasing obligations, in case of individualised threshold, which is typically defined as a percentage of the customer’s purchasing requirements or as a specific volume target, the loyalty-enhancing effect is maximum, since the dominant firm is assumed to be able to set the threshold at a level that corresponds to the customer’s entire demand. Instead, in case of standardized threshold, which is usually expressed as a generic volume target equal for all customers, the loyalty-inducing effect may be high for smaller customers and low for larger customers. As it should be, the Commission is then likely to intervene only if the standardized threshold reflects the purchasing requirements of a substantial proportion of the total demand (Guidance Paper, paragraph 45).

3.1. The First Phase of the As-Efficient Competitor Test: the Estimation of the Contestable Demand

In the first phase of the price-cost test, for an incremental rebate, the relevant range of sales that is necessary to consider in order to verify the pro-competitive or anti-competitive nature of the discount scheme is normally equal to the part of sales made above the threshold. On the contrary, for a retroactive rebate, it is required to estimate the contestable portion of the customer’s demand, that is the part of sales a rival firm could realistically compete for against the dominant firm. If customers are in conditions such as to switch large part of the demand to an actual or potential competitor, then the relevant range would be large. On the contrary, if customers are in conditions such as to switch only small part of the demand, then the relevant range would be small. As practical guidelines, for an existing competitor, a helpful indication of the relevant range may come from the data related to the fluctuations of sales over time, whereas, for a potential competitor, an useful suggestion may derive from the evaluation of the scale of sales that reasonably a new entrant would be able to reach. In case this calculation would be difficult to assess, it is advised to observe the past trend registered by new entrants in the same or similar markets (Guidance Paper, paragraph 42).

The essential condition for a discount system to cause a risk of anti-competitive foreclosure consists in the control by the dominant firm of a substantial share of the customer’s requirements, i.e. the so-called assured base of sales. As in case of exclusive dealings, the key factors which allow a dominant undertaking to benefit from an inelastic portion of the demand may be several, such as, for instance, brand loyalty due to the necessity for dealers and retailers to offer must-stock items produced by dominant firms, capacity constraints faced by rival firms, reputational effects which prevent competitors from selling high amounts of units before the own product has been tested by customers, switching costs suffered by consumers (Guidance Paper, paragraph 36). Therefore, assuming that rival firms may not be able to compete for the entire demand since dominant firms play generally the role of an unavoidable trading partner, in case of retroactive rebates the enforcement guidance requires estimating the volume of sales which can be judged contestable.

The main consequence of the existence of an assured base of sales over which the dominant firm holds a significant market power is that the customer would in any case acquire a certain amount of its purchasing requirements from the latter, despite the fact that a rival firm could be able to offer a product of higher quality at a lower price. Nevertheless, an anti-competitive foreclosure arises only if an equally or even more efficient competitor is unable, not to compete for the entire size of the customer’s demand, but just for the portion of demand which is not monopolized by the dominant firm. In fact, in order to reimburse the customer for the loss of the discount proposed by the dominant undertaking, the rival firm could be obliged to apply a very high discount on the limited amount of contestable sales still left open to competition. The principal purpose of the price-cost test is therefore to ascertain if an “as-efficient” competitor would be capable of competing without incurring any loss with the price following the implementation of a dominant firm’s retroactive scheme. Since both beneficial and harmful loyalty pricing tend to target the marginal expenditure that customers may switch to other competitors, the focus has to be on the contestable demand.

3.2. The Second Phase of the As-Efficient Competitor Test: the Estimation of the Effective Price

In the second phase of the price-cost test, in case of retroactive rebates, it is required to estimate the average price a competitor would need to propose to the customer to reimburse it for the loss of the discount offered by the dominant firm, which is caused, as mentioned, if the customer switches part of its demand from the dominant to the rival firm (in case of incremental rebates, the effective price is simply equal to the discounted price granted to the additional units purchased above the threshold). In this regard, it is worth noting two characteristics concerning the compensating price the rival firm must match. Firstly, it is not equal to the discounted price proposed by the dominant firm, which instead is equal to the list price minus

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12 Supra note 3, pp. 379.
13 Supra note 3, pp. 379.
the premium recognized on all the previous purchases. In fact, the rival firm can refund the customer of the rebate lost from the dominant undertaking only relying on the contestable demand. Hence, the effective price the rival firm must offer to match the dominant firm’s discounted price would certainly be lower than the latter. Secondly, it increases as the level of sales made by the rival firm and thus the contestable demand increases, because the competitor is progressively in a better position to recoup over a higher number of units the discount lost by the customer\textsuperscript{15}.

Accordingly, it is possible to show graphically the relationship between the effective price (in percentage terms of the dominant firm’s discounted price) and the level of sales (in percentage terms of the customer’s total demand) that the rival firm respectively has to offer and make in order to leave the customer indifferent between the offers proposed by the two competitors (cf. Figure 2)\textsuperscript{16}. Nevertheless, the level of sales a rival firm may realize is constrained by and depends on the contestable portion of demand. Assuming for instance in the graph below that the contestable demand is equal to 40\% of the total demand and that the discount rate offered by the dominant firm is equal to 15\% of the list price, the curve representing the effective price indicates that the rival firm would need to offer a compensating price equal to 73,50\% of the dominant firm’s discounted price, which in turn is equal to a 37,50\% discount rate of the list price. From the example, therefore, it is possible to observe how the existence of a limited portion of contestable demand strongly influences the capacity of a competitor to compete. In fact, the rival firm would need to more than double the discount offered by the dominant undertaking in order to remain competitive in the market concerned.

Figure 2 - Contestable Demand and Effective Price

\textsuperscript{15} Supra note 14, pp. 280.
\textsuperscript{16} Supra note 14, pp. 280.
In analytical terms, the effective price a rival firm must offer to match the dominant firm’s rebate scheme may be expressed by the following equation (cf. formula 2)\(^{17}\). As a result, in relation to the effective price it is possible to state that: it decreases as the discount rate and the non-contestable share of demand increase; it increases as the contestable share of demand increases; it is positive if the contestable share of demand is higher than the discount rate; it is equal to zero if the discount rate is equal to the contestable share of demand, meaning that it is impossible for a rival firm to sell the product at a positive price and therefore at a profitable level. Furthermore, from the mathematical formula below shown, it is possible to understand why a discount system does not generate distortions and thus problems from a competition law point of view if a rival firm is in the conditions to equally compete with the dominant firm for the total customer’s purchase requirements\(^{18}\). In fact, if the dominant firm cannot benefit from an assured base of sales, implying that a distinction between contestable and not-contestable demand is not necessary, then the price the rival firm must offer to remain competitive in the relevant market is exactly the same as the dominant firm’s discounted price. Consequently, the type of price competition that follows benefits rather than reduce the general level of consumer welfare.

**Formula 2 - Mathematical Formula for the Effective Price**

\[
P^e = P^l \left[ \frac{X - r (X + Y)}{X} \right] / X
\]

\[
D = X + Y = 1
\]

\[
P^e = P^l \left[ \frac{1 - (r/X)}{X} \right]
\]

\[
P^e = \text{effective price}
\]

\[
P^l = \text{list price}
\]

\[
r = \text{discount rate}
\]

\[
D = \text{total demand}
\]

\[
X = \text{share of demand contestable}
\]

\[
Y = \text{share of demand non-contestable}
\]

As the ultimate objective of the price-cost test is to evaluate whether the effective price following the adoption of a retroactive rebate by a dominant firm may be potentially matched by an equally or even more efficient competitor using the contestable portion of demand, it is necessary, as final step, to compare the value of the compensating price with a correct cost benchmark, verifying if the former is above or below the latter. In respect of the As-Efficient Competitor analysis as defined by the Commission in its enforcement guidance, as in case of price discrimination, the measures of cost to be used to distinguish between pro-competitive and anti-competitive forms of discounting are those relative to the dominant firm.


\(^{18}\) *Supra* note 14, pp. 280.
In fact, the essential motivations that support the employment of the cost structure of the dominant firm and not of the rival firm as term of comparison are: the price-cost test aims to safeguard only competitors that are as-efficient as the dominant undertaking; the use of the cost structure of the dominant firm as key parameter permits to establish whether its conduct entails a profit sacrifice, in which case it is possible to judge the latter as exclusionary, since its only economic justification is the desire to reduce the level of competition\textsuperscript{19}.

In this context, the main rules for the assessment of the exclusionary effect produced by a retroactive rebate on actual or potential competitors are mainly two: if the effective price associated to the contestable demand is below the Average Avoidable Cost (AAC) of the dominant firm, then the retroactive rebate is considered capable of foreclosing an equally or even more efficient competitor, thus it must be judged abusive; if the effective price is between the Average Avoidable Cost (AAC) and the Long Run Average Incremental Cost (LRAIC) of the dominant firm, then the retroactive rebate would not be normally capable of generating an anticompetitive foreclosure, since an equally or even more efficient competitor would be able to compete profitably despite the presence of the dominant firm’s retroactive rebate\textsuperscript{20}. In the latter case, the Guidance Paper calls for the opening of a further investigation by the Commission, in order to verify if, beyond the cost-based measures, the other elements available confirm or reject the position according to which the entry or the expansion by an as-efficient firm in the relevant market is obstructed. Therefore, the enforcement guidance requires considering all the effective and realistic counterstrategies that are at disposal of competitors to compete with the dominant undertaking, such as, for instance, the power to use the non-contestable portion of demand of the own customers as leverage to reduce the price linked to the contestable portion of demand (Guidance Paper, paragraph 44).

It should be noted that the use of cost-based measures needs to define a time frame for the evaluation of the conduct. Obviously, for a discount scheme, the relevant period over which it is applied represents the most appropriate temporal benchmark to realize the comparison between the level of effective price and the level of avoidable cost. Nevertheless, as the reference period increases, costs become more avoidable and incremental. Consequently, it is extremely important to be able to calculate the exact reference period, because its determination results critical to assess whether the effective price is above or below the relevant cost-based measures and thus crucial to judge the potential foreclosure of actual or potential competitors\textsuperscript{21}. As a result, cost-based rules remain a helpful but imperfect tool to measure the exclusionary nature of the commercial practices at issue. Therefore, a facts-based analysis capable of estimating the entire competitive harm seems not only desirable, but also indispensable, as it will be examined in details in the next sections.

\textsuperscript{19} Supra note 14, pp. 280.
4. **Critical Assessment of the As-Efficient Competitor Test**

Although part of the criticisms addressed to the price-cost test designed by the European Commission in its Guidance Paper appear rather reasonable (in essence the complexity to estimate the effective price), the proposal frequently advanced in the academic debate by numerous commentators to abolish completely the model based on the concept of contestable demand and to adopt, along the lines of the US antitrust system, a standard predatory test\(^{22}\), applying the latter on the quantity of units that once reached triggers retroactively the conditional rebate, seems to be not justified from an economic perspective. In fact, notwithstanding a standard predatory test would certainly result much more straightforward to implement than the more difficult contestable share test, at the same time it would risk to be excessively simplified and to cause a false-positive error, judging lawful a conduct that instead is direct to foreclosure and eliminate a competitor (cf. Example 3)\(^{23}\).

**Example 3 (Part I) - Contestable Share Test and Standard Predatory Test**

The dominant firm sells to the customer an unit of product, whose average cost is of 0,90€, at a list price of 1€. Furthermore, the customer’s total demand is equal to 120 units and the dominant firm grants a retroactive rebate of 5% if the customer reaches a volume threshold of 100 units. At the same time, an as-efficient competitor, which may potentially attract a maximum of 40 (i.e. customer’s contestable demand) of the 120 units available (i.e. customer’s total demand) is willing to enter in the market. However, applying a standard predatory test on the threshold volume, the retroactive rebate proposed by the dominant firm would not be judged exclusionary, since the latter would be able to bear total costs of 90€ (total sales times average cost: 100x0,90€) and to obtain total revenues of 95€ (total sales made at the list price, minus discount rate applied to total sales: 100x1€ - 100x5%), for a final and positive level of profits of 5€. Thus, the dominant firm’s retroactive rebate, not entailing a profit sacrifice, would be considered lawful.

As a matter of fact, a standard predatory test would risk to neglect the importance of the factor “scale of production”, not performing a correct As-Efficient Competitor analysis. In fact, a rival firm is unlikely to be able to remain competitive in the market relying only on the quantity of units corresponding to the difference between the customer’s total demand and the dominant undertaking’s threshold volume. Even if it aims to sell exclusively the incremental units above the threshold, being consequently constrained to match only the dominant firm’s discounted price but not to offer the much lower effective price that would recompense the customer for the loss of the discount proposed by the dominant firm, the rival firm would probably not survive, since it would be incapable, counting merely on a very limited amount of units, to achieve an efficient scale of production. Therefore, it is plausible to assume that the competitor, in order to reach an optimal scale of operations, would be forced to supply a quantity of units higher than the incremental units above the threshold and thus it would be obliged to convince the customer to switch, renouncing to the dominant firm’s retroactive rebate.

Example 3 (Part II) - Contestable Share Test and Standard Predatory Test

Since the customer’s total demand is equal to 120 units and the threshold set by the dominant firm is equal to 100 units, if the rival firm competes just for the quantity of units above the threshold, i.e. 20 units, the customer can still continue to buy 100 units and to benefit from the dominant firm’s retroactive rebate. Thus, the price the rival firm must match is equal to 0,95€, i.e. the price discounted the customer pays to the dominant firm for the incremental units once the threshold has been crossed. However, the rival firm, in order to achieve its minimum efficient scale of production and to remain competitive in the market, could be forced to sell more than the incremental units above the threshold. Nevertheless, counting only on the contestable demand, which is equal to 40 of the 120 total units, the rival firm would be obliged to offer to the customer an effective price of 0,85€ (applying the Formula 2 above shown: 1 [1 - (5% / 33%)], being the contestable portion of demand equal to 40/120), which is not sufficient to cover the average cost of 0,90€. Likewise, the effective price of 0,85€ can be calculated as difference between the total amount the customer would pay if it satisfies its total demand from the dominant firm (120×0,95€ = 114€) and the total amount the customer would pay if it satisfies only its non-contestable portion of demand from the dominant firm switching its contestable portion of demand to the rival firm (34×0,85€ = 29,3€). As a result, the rival firm would need to sell at least 60 units ([1 - (5% / 50%)] = 0,90, being 50% (60/120) the market share the rival firm must supply to reach its minimum efficient scale of production), in order to offer a price equal to the average cost and to not suffer a loss, despite the fact it faces potentially the same costs as the dominant firm (average cost per unit of 0,90€ for both firms).

As the example shows, although the retroactive rebate granted by the dominant undertaking does not entail a profit sacrifice, the rival firm, given that it can rely only on the contestable portion of demand, is forced to offer an effective price below cost, which in the long-term would oblige the same firm to exit from the market. Therefore, notwithstanding the competitor is as-efficient as the dominant firm, the fact that the contestable demand is not large enough to permit to the rival firm to achieve its minimum efficient scale of production would make it unable to compete even for the portion of market still left open to competition. Thus, the application of a standard predatory test would be erroneous, since it is likely to judge lawful a retroactive rebate offered by a dominant undertaking, even though, as it has been demonstrated in the example, it is actually capable of foreclosing an equally efficient competitor.

It is for this main reason that the antitrust assessment of a dominant firm’s retroactive rebate, in order to be sound economic, should always evaluate whether the portion of the market still left open to competition allows an as-efficient competitor to achieve its optimal scale of production. After all, it is reasonable to assume that a dominant firm is generally able to act distinguishing the monopolized portion of the customer’s demand from its contestable share, at least for the largest customers. As a result, albeit the estimation of the contestable share as well as of the loss of the conditional rebate are more difficult to determine than the measurement of the same costs of production, this does not exempt the EU institutions from the duty to bear the higher workload the new approach requires to reach a more precise analysis result.

5. EU Case-Law: Tomra

In 2006 the European Commission imposed a fine amounting to 24 millions euro on the multinational corporation Tomra for violation of the EU antitrust rules on abuse of dominant position (Article 102 of the TFEU) by engaging in a combination of prohibited conducts capable to exclude competitors from the market of the so-called “reverse-vending machines”, which are generally installed in outlets and supermarkets to facilitate the collection of empty and used beverage containers for recycling purposes. The infringements, committed by Tomra and detected by the Commission after a complaint lodged by the German manufacturer Prokent, basically consisted in the implementation of a system of commercial contracts, containing practices categorizable as exclusivity agreements, individualized quantity commitments and individualized retroactive rebates, employed in the sale of the machines at issue to large retailers active in 5 national markets (Austria, Germany, Netherlands, Norway, Sweden), where the Norwegian group operated through its local subsidiaries.

The Commission determined that, during the period of the infringement (1998-2002) and in the countries under examination, on average Tomra’s market shares were approximately 80 percent and the practices in question foreclosed around 40 percent of the total demand. The investigations undertaken by the Commission eventually concluded that the unilateral conducts adopted by Tomra impeded or at least made more difficult the market entry of new competitors, although in some cases rival suppliers were completely eliminated because of acquisitions or insolvencies. In 2010, following an application for annulment of the Commission Decision advanced by Tomra, where the company essentially complained that the latter was based on unreliable elements to prove the exclusionary intent of the practices objected, the General Court of the European Union substantially confirmed and upheld the evaluation carried out at first instance, according to which the commercial strategies utilized by the Scandinavian group caused an anti-competitive foreclosure on actual and potential competitors such as to lead to consumer harm.

The particular interest generated by the Tomra case in the antitrust community resides in the fact that it represents the first proceeding where both the Commission (2006) and the Court (2010) deal with the new effects-based approach to loyalty discounts designed in the Discussion Paper (2005) and embraced in the Guidance Paper (2009). In fact, as mentioned, among the abuses alleged, the most prominent was a series of retroactive rebates granted by the Norwegian group. However, in the light of a critical assessment of both the decision issued by the Commission and the judgement rendered by the Court, it is possible to state that only partially the test proposed to verify the presence of an exclusionary conduct has been satisfied.

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5.1 The Decision of the European Commission (2006)

In an article published in the Competition Policy Newsletter of the Directorate General for Competition (DG COMP)\(^{26}\), members of the case team working in the Tomra case offer the possibility to better comprehend and reconstruct the economic reasoning developed by the Commission in its decision to reject the defence presented by the Norwegian firm (in fact, at paragraphs 364-390, the text of the decision describes only in a formal manner the theoretical model proposed by Tomra, whereas the article reports also a numerical example submitted by Tomra as response to the statement of objections, although in both cases the logic remains of course the same). The combined analysis of the two documents results therefore essential to evaluate the application made in the case at issue of the new effects-based approach towards retroactive rebates adopted in the Guidance Paper. Thus, in the present section, the focus will be on the economic assessment introduced and realized by the Commission, while in the next section, the focus will be on the legal assessment confirmed and extended by the Court.

5.1.1. The Economic Reasoning developed by Tomra

The economic report presented by Tomra assumes the following scenario. A dominant firm sells to the customer an unit of product at a list price of 1 €. Furthermore, the customer’s total demand is equal to 120 units and the dominant firm grants a retroactive rebate of 10% if the customer reaches a volume threshold of 100 units. Moreover, the economic report assumes the extreme situation where the suction effect produced by the retroactive rebate is maximum, that is in correspondence of the last unit before the threshold (i.e. an amount of units purchased by the customer equal to 99). Hence, if the customer increases the quantity of units purchased from 99 to 100 triggering the discount of 10%, the customer pays a negative price of 9 € for the 100\(^{th}\) unit and the total revenues the firm obtains fall from 99 € to 90 €. Therefore, counting only on the contestable demand, which is equal to 21 of the 120 total units, the rival firm would be obliged to offer to the customer an effective price of 0,43 € (applying the Formula 2 above shown: 1 \[1 - (10\% / 17,5\%)]\), being the share of contestable demand equal to 21/120). Likewise, the effective price of 0,43 € can be calculated as difference between the total amount the customer would pay if it satisfies its total demand from the dominant firm (120×0,90 € = 108 €) and the total amount the customer would pay if it satisfies only its non-contestable portion from the dominant firm switching the contestable portion to the rival firm (120-21×1 € = 99 €), all divided by the contestable demand (9/21 = 0,43 €). Thus, according to Tomra, even if calculated on the last unit, the effective price the rival firm should match would be feasible for any competitor, being sufficient to cover the average cost of production (in fact, judging from the article, the average cost of production borne by Tomra seems to be lower than 0,43 €).

Figure 3 illustrates the effective price the rival firm must offer to recompense the customer in case of loss of the discount proposed by the dominant undertaking\textsuperscript{27}. Furthermore, the graph shows two other extreme cases. On one side, if the rival firm competes just for the quantity of units above the threshold, i.e. 20 units, then the customer can still continue to buy 100 units and to benefit from the dominant firm’s retroactive rebate. Thus, the price the rival firm has to match is equal to 0,90€, i.e. the price discounted the customer pays to the dominant firm for the incremental units once the threshold quantity has been reached. On the other side, if the rival firm is able to compete for the entire size of the customer’s demand, i.e. 100 units, then the retroactive rebate granted by the dominant firm loses its loyalty effect, turning into a price cut. Again, the price the rival firm must match, in order to take away all customers from the dominant firm, is equal to 0,90€.

Between the two extreme cases, the rival firm is obliged to offer to the customer an effective price below 0.90€. In particular, the more units the rival firm sells, the higher is the price it can charge, being gradually in a better position to recoup over a larger number of units the retroactive rebate lost by the customer. On the contrary, in the worst scenario, that is where the rival firm has only an additional unit over which to spread the discount (i.e. 21 units sold by the rival firm and 99 units sold by the dominant firm), the rival firm must cut the price until the minimum level of €0.43, in order to leave the customer indifferent between its offer and the one proposed by the dominant undertaking.

In conclusion, the defence presented by Tomra is essentially based on the analysis of the average price the rival firm must offer to compete with the retroactive rebate granted by the dominant undertaking: the focus is in fact on the average price per unit (theoretically, the rival firm could adopt a non-linear pricing, setting a certain price for the 20 units above the threshold and a different price starting from the 21st unit onward)\textsuperscript{28}. However, the final aim of the economic reasoning developed by Torma is to demonstrate that an as-efficient competitor would be able to compete profitably, covering the costs of production even in the worst case, that is when it sells just the sufficient quantity of units that prevents the customer from benefiting from the retroactive rebate and that obliges the rival firm to offer the lowest effective price possible in order to compensate the customer for the discount lost.

### 5.1.2. The Economic Reasoning developed by the European Commission

The Commission rejects the analysis proposed by Tomra, since the behaviour of the rival firm would not be profit maximizing (although, it is important to underline, it does mean that it would not obtain a positive profit in case it matches the retroactive rebate granted by the dominant undertaking selling 21 units). In fact, for the rival firm would be more convenient and rational to forego the last unit and to sell exclusively the incremental units above the threshold (i.e. 20 instead of 21 units), being constrained to match only the dominant firm’s discounted price (i.e. 0.90€) but not to offer the much lower effective price that would compensate the customer for the loss of the discount (i.e. 0.43€).

As a result, renouncing to offer the last unit, the rival firm would obtain total revenues of 18€ (total sales of the units above the threshold times discounted price: 20×0,90€), instead of 9€ (total sales of the units above plus last unit before the threshold, times effective price: 21×0,43€), which it would result a better solution to choose. Furthermore, not only the rival firm would lose revenues selling the marginal unit at a negative price, but it would dispense the dominant firm from granting the rebate, increasing the revenue gap between the two competitors\textsuperscript{29}.

\textsuperscript{28} Supra note 27, pp. 2-4.
Figure 4 illustrates the higher level of total revenues the rival firm would obtain in case it renounces to the last and marginal unit and sells only the units above the threshold at the discounted price (i.e. area shaded by vertical lines), in comparison with the lower level of total revenues the rival firm would obtain in case it sells also the last and marginal unit at the effective price, matching the retroactive rebate granted by the dominant firm (i.e. area shaded by horizontal lines)\textsuperscript{30}.

\begin{figure}[h]
\centering
\includegraphics[width=0.5\textwidth]{figure4.png}
\caption{The Economic Reasoning developed by the European Commission}
\end{figure}

$$P^L = \text{list price}$$
$$P^D = \text{discounted price}$$
$$P^E = \text{effective price}$$
$$D = \text{total demand}$$
$$X_t = \text{total units necessary to reach the threshold}$$

5.1.3. Critical Assessment

The prohibition decision issued by the Commission in the Tomra case is mainly based on the observation that the retroactive rebate granted by the dominant undertaking would force the rival firm to adopt an irrational behaviour, obliging it to bear an unnecessary loss and to renounce to a higher level of profits. However, the approach adopted by the Commission, since it appears to focus exclusively on the last unit prior to the threshold and to imply the equation negative price for the marginal unit equal to exclusionary foreclosure, risks to establish a per se prohibition for any type of retroactive rebate.

\textsuperscript{29} The Commission explains in the following terms why compensating and matching the retroactive rebate, bearing a loss at the margin, does not make economic sense, being against the individual rationality: “Selling all $D-(T-1)$ units implies making profits of $(D-T)p^*$ minus the negative price of the marginal unit before the threshold. This clearly violates individual rationality. […] It makes no sense to behave like this because by taking the unnecessary loss of selling the marginal unit, the incumbent avoids paying out the rebate. In fact, stepping in with a negative price saves the incumbent from paying out the rebate” (paragraphs 388-389 of the Commission Decision).

As it has been demonstrated above in the economic analysis of loyalty discounts and rebates, the incremental price, which a customer has indirectly to pay for the marginal units necessary to reach the threshold, most of the times results negative. Given the non-linear and rollback nature of the rebate, the total expenditure borne by the customer faces a discontinuity in correspondence of the threshold. As a result, an assessment that focuses solely on the units in proximity of such discontinuity seems incomplete because it ends up stating that the retroactive rebate is exclusionary just because it entails a negative price for the units close to the purchasing target. In fact, the same DG Competition Discussion Paper had already suggested in 2005, even before the publication of the final Guidance Paper in 2009, that: “The suction effect in principle is strongest on the last purchased unit of the product before the threshold is exceeded. However, what is relevant for an assessment of the loyalty enhancing effect is not competition to provide an individual unit, but the foreclosing effect of the rebate system on commercially viable amounts supplied by (potential) competitors of the dominant supplier” (paragraph 154 of the Discussion Paper, substantially reproduced in the paragraph 40 of the Guidance Paper).

Furthermore, as it has been explained above in the critical assessment of the As-Efficient Competitor test, a retroactive rebate causes an anti-competitive foreclosure only if the dominant firm faces an inelastic portion of the demand, which in turn prevents the rival firm from reaching its minimum efficient scale of production (as shown, the contestable portion of the customer’s demand would oblige the rival firm to offer a below cost price). What is extremely important in detecting the anti-competitive effect of a retroactive rebate is therefore to demonstrate the presence of an assured base of sales, which however must not be assumed to exist just because there is a dominant firm in the relevant market.

As a result, in the theoretical example advanced by Torma and rejected by the Commission, two critical considerations appear necessary. Firstly, assuming for the purpose of the present critical assessment that the average cost per unit is equal to 0,30€, only if the assured base of sales is at least equal to 86 units, the retroactive rebate would oblige the rival firm to offer a below cost price (applying the Formula 2 above shown: 1 [1 - (10% / 14%)] = 0,29€, being the share of contestable demand equal to 14/100). It is worthy to note that in our analysis, as a conservative assumption, we count only the contestable units below the threshold (i.e. 16 units) and not, as instead Tomra assumes, also the units above the threshold (i.e. 20 units, being the customer’s total demand equal to 120 units and the threshold set by the dominant firm equal to 100 units, for a total of 36 contestable units, as Tomra would suppose, over which the rival firm could recoup the retroactive rebate). Considering the units above the threshold as not foreclosed, one could argue that it is not correct to count these units before as not closed to competition and then to use the same units to deny the existence of an anti-competitive foreclosure, as Tomra seems to do with its average logic.

31 European Commission (2005), DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, Belgium.
Secondly, assuming a more realistic scenario where the inelastic portion of the customer’s demand is at a lower level than the one supposed in the extreme scenario proposed by Tomra and analysed by the Commission, such that an as-efficient competitor could compete at least for 32 units, the result would be a higher level of profits for the rival firm in case it matches the retroactive rebated granted by the dominant firm compensating the customer for the discount lost, than in case it sells only the units above the threshold. In fact, in the first case, the rival firm would obtain total profits of 12.4€ (total units below the threshold times effective price, 32×0.69€, all minus the relative costs, 32×0.30€; applying the Formula 2 above shown, the effective price is equal to: 1 \[1 - (10\% / 32\%)] = 0.69€, being the share of contestable demand equal to 32/100), instead of 12€ (total units above the threshold times discounted price, 20×0.90€, all minus the relative costs, 20×0.30€).

Also here, it is worthy to note that, given the conservative assumption above-mentioned, we count only the contestable units below the threshold (i.e. both the dominant and rival firm would remain totally free to compete for the units above the threshold, over which however we do not spread the loyalty discount for the calculation of the effective price). Thus, in a more realistic scenario, the rival firm, through the margins gained from the expansion of production on the incremental units, would be able to more than compensate the discount lost by the customer, earning a level of profits higher than the one it would obtain if it competes just for the 20 units above the threshold.

Even in the extreme scenario where the dominant firm sets the threshold level perfectly equal to the customer’s demand, the rival firm could profitably match the retroactive rebate granted by the dominant undertaking. In fact, if the average cost is lower than 0.40€, the rival firm, selling 21 units, would obtain a positive profit, despite the fact that the implicit price of the first units would be negative. The critical assessment here developed demonstrates therefore how, in the theoretical example advanced by Torma and rejected by the Commission, the focus on the last marginal unit brings only to a partial analysis, which does not permit to express a complete judgement about the possibility for the rival firm to contest the retroactive rebate granted by the dominant firm (as it has been show, in fact, the loss of profit in correspondence of the cross from the 20th to the 21st unit could be more than compensated in a more realistic scenario)\(^{32}\).

In conclusion, the main problem in the economic reasoning developed to reject the Tomra’s defence is that it generalizes and overestimates an evident and narrow result to state that the rebate system granted by the dominant undertaking is capable of foreclosing actual or potential competitors. However, if the price a rival firm has to contest is calculated only on very limited portion of contestable demand, the risk is to protect inefficient firms from a healthy and lawful price competition.

\(^{32}\) Supra note 27, pp. 4.
5.2 The Judgement of the General Court (2010)

In the Tomra case, the Court, losing the opportunity to launch the envisaged application of an economic analysis to unilateral conducts by dominant firms, confirmed the established case-law, considering the evaluation of the actual effects produced on the relevant markets by the alleged abuses not necessary. In fact, entirely consistent with the position adopted by the Commission in relation to the key points of the case in question, the Court essentially based its judgment on the mere capability of the strategies undertaken by the Norwegian group of foreclosing its main competitors. In the light of this premise, it is the Court itself, in the course of its ruling, to disregard any in-depth examination of the economic assessment carried out by the Commission to ascertain the unlawful nature of the practices objected to Tomra, dismissing the appeal made by the company primarily founded on economic arguments.

5.2.1. Intention to Foreclosure vs Intention to Harm

The judgement rendered by the Court starts making the following observations: a rebate scheme which has a foreclosure effect on the relevant market must be considered abusive if it is applied by a dominant firm (paragraph 211); in order to evaluate whether a rebate scheme must be deemed abusive, it is necessary to verify if, “following an assessment of all the circumstances”, it is “capable” or “intended” to restrict the level of competition on the concerned market (paragraph 215). Therefore, although the Court, likewise the Commission, seems to recognize a rule of reason rather than a per se rule given the requisite to evaluate “the circumstances” and “the context” in which the practice takes place, its ruling actually does not explain what an examination of the “the circumstances” and “the context” of the case must incorporate. The Court, approving completely the approach endorsed in the Commission Decision, does not provide any further and specific guidance in regard. In addition, this clarification appears to be in contrast to what rightly declared in relation to the intention to harm. In fact, the Court states that the Commission has not based its decision against Tomra neither on its internal documentation, nor on its premeditated actions, being merely facts useful to contextualize the alleged practices, but without any substantial impact on the finding of abuse (paragraphs respectively 39 and 40).

5.2.2. As-Efficient Competitor Test

In its appeal, Tomra basically affirms that the Commission, in order to establish the existence of an anti-competitive foreclosure, has erroneously focused on the “content” of the agreements rather than on the “context” of the markets (paragraph 200). Consequently, the applicant advances the economic argument

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according to which the coverage of its agreements was not sufficiently large to be capable of having an exclusionary effect on an as-efficient competitor, demonstrating that its practices affected only a limited part of the market, whereas the residual part continued to be completely contestable (on average around 61% for the five national markets). Furthermore, the company emphasizes the fact that the Commission, contrary to what advocated in the Discussion Paper, has not verified whether the market situation was such to allow to one or more competitors to compete profitably, neither estimating the contestable portion of the customer’s demand and the minimum viable scale, nor performing a quantitative price-cost test to prove empirically the capability of the alleged practices of foreclosing competitors and harming consumers. On the contrary, it has merely calculated on the last units the incremental price a rival firm would need to offer to match the retroactive rebate granted by the dominant firm. In particular, in the opinion of Tomra, the Commission Decision has not shown the capability of retroactive rebates of forcing the main rivals to set a below cost price (paragraphs 247-249).

Notwithstanding the claim filed by Tomra was based on a solid background being in line with the Guidance Paper, the Court rejects totally such plea, asserting that the foreclosure of a substantial part of the relevant market cannot be defended by displaying that the size of the contestable market is enough to permit to a limited number of rival firms to compete. In this regard, the three principal motivations provided by the Court are: firstly, “the customers on the foreclosed part of the market should have the opportunity to benefit from whatever degree of competition is possible on the market” (paragraph 241); secondly, “the competitors should be able to compete on the merits for the entire market and not just for a part of it”, as well as “it is not the role of the dominant undertaking to dictate how many viable competitors will be allowed to compete for the remaining contestable portion of demand” (paragraph 241); thirdly, “it is difficult to concur with the applicants’ argument that a competitor may offset the lower prices that it is obliged to charge a customer for units below the threshold by selling additional units to the same customer (above the threshold). In fact, that customer’s remaining demand is at best limited, so the competitor’s average price will remain structurally unattractive” (paragraph 270), statement which seems to resemble what assumed by the Commission in its decision, that is, given the presence of a retroactive rebate, if the customer’s demand is higher than the threshold level then all units below the latter are foreclosed, or if the if the customer’s demand is lower than the threshold level then the entire customer’s demand is foreclosed (paragraphs 365-377).

However, it is important to notice that the three lines of reasoning above-mentioned appear to be affected by as many flaws. In the first statement, the Court does not focus on the market foreclosure but on the customer foreclosure, therefore it seems to consider also a customer foreclosure itself as an abusive conduct (a such reasoning, for instance, would be particularly risky in case of exclusive dealings)35.

In the second statement, it seems to assume that any retroactive rebate entails an abusive foreclosure, when instead it should be presumed only in case it is granted to the entire demand (a such reasoning, in extremis, would lead also an 1 percent coverage under the scrutiny of the Article 102 of the TFEU\textsuperscript{36}; despite this, the fact that a loyalty scheme generates a foreclosure effect resides in its nature, but it certainly does not mean that it is anti-competitive and thus able to influence the entry or exit decision of a rival firm). In the third statement, which appears as the most problematic, it seems to suppose that, given the existence of a retroactive rebate and the fact that the price set by the dominant firm for the incremental units before the threshold is likely to be very low, the compensating price the rival firm must offer would remain “structuring unattractive”, even in the case the rival firm is able to use the units above the threshold as leverage to counterbalance the lower price to be offered for the units below the threshold\textsuperscript{37}.

In fact, as it has been shown in the previous sections, the Guidance Paper expressly states that in order to correctly evaluate the exclusionary nature of a retroactive rebate is not exact to focus exclusively on the marginal incremental unit before the threshold (and in more general, on the last units, as the Court seems to do), but instead it is necessary to realize a complete examination of the rebate structure (Guidance Paper, paragraph 40: “what is in the Commission’s view relevant for an assessment of the loyalty enhancing effect of a rebate is not simply the effect on competition to provide the last individual unit but the foreclosing effect of the rebate system”). For this purpose, it is thus required to calculate the effective price a rival firm would need to set to match the dominant firm’s rebate system (Guidance Paper, paragraph 41: “the Commission will estimate what price a competitor 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”). Only doing this, it is possible to verify whether an equally efficient rival would be able to compete profitably, relying on the contestable portion of the customer’s demand (Guidance Paper, paragraph 42: “it will generally be relevant to assess in the specific market context how much of a customer’s purchase requirements can realistically be switched to a competitor”).

As it has been demonstrated above in the economic analysis of loyalty discounts and rebates, even if the average price a rival firm must offer to the customer is lower than the discounted price proposed by the dominant firm, it does not absolutely mean that for the former would not be profitable, using the contestable portion of the customer’s demand at its disposal, to match the retroactive rebate granted by the latter, even at the cost of bearing a negative incremental price for the units around the threshold. The presumption on which the third statement is based appears therefore to be not justified from an economic standpoint. Only after having applied a price-cost test such as the one designed by the Commission and performed in the Intel case\textsuperscript{38}.


(section 4.2.3 of the Commission Decision, where it is shown that the contestable share at disposal of the main rival ADM was not sufficient to contest the discount scheme offered by Intel), a similar conclusion could be reached, showing that the effective price a rival firm would need to match is below cost. As a result, being in sharp contrast to the new approach recommended in the Guidance Paper, this passage can be indubitably considered as the least satisfactory part of the analysis made by the two EU institutions.

Moreover, in this respect, the Court makes a further questionable assertion in the section of the judgement where it seems to implicitly affirm that one of the essential aim of Article 102 of the TFEU is the protection of competitors, in parallel to and separately from the protection of consumers (paragraph 206: “the prohibition laid down in that provision is - also - justified by the concern not to cause harm to consumers”, emphasis added). Consequently, according to the Court, both the protection of competitors or the protection of customers would be a sufficient reason to find an abuse, when instead the Commission in its Guidance Paper affirms that it is necessary to detect simultaneously an anti-competitive foreclosure leading to consumer harm. In fact, what matters is “protecting an effective competitive process and not simply protecting competitors”, as well as “to ensure that dominant undertakings do not impair effective competition by foreclosing their competitors in an anti-competitive way, thus having an adverse impact on consumer welfare” (Guidance Paper, respectively paragraphs 5 and 19).

5.2.3. Form-Based Approach vs Effects-Based Approach

As a matter of fact, in the Commission Decision, it must be recognized that an economic analysis of the actual effects of the alleged practices is not totally absent. However, in the present assessment, for form-based analysis we do not simply mean that a certain conduct is presumed abusive if it presents predetermined and specific characteristics, but rather the absence of an deep examination of the conduct in terms of consumer and competition harm. In fact, the analysis carried out by the Commission appears limited to: the comparison between the tied markets shares and the market shares held by the Norwegian group (on the base of the equation: the higher the former, the more stable the latter, the less strong the competitors); the fact that the prices set by Tomra, despite the rebates granted, did not fall but rose; the observation of the Prokent’s insolvency. In its petition, Tomra contests these findings, showing on the contrary that: the diagrams illustrating the suction effect contained mathematical errors; most of the results provided by the Commission were contradicted by empirical evidence; the prices did not increase and were not negative, even considering only the last unit before the threshold; the relationship between the tied markets shares and the market shares held by Tomra was statistically inconsistent; the German supplier left the market only after the termination of the alleged abuses.

39 Supra note 36.
40 Supra note 35, pp. 2-3.
Nonetheless, it is the same Court to eventually clarify the matter, explicitly admitting that the Commission has not based its finding of abuse on the actual impact of the alleged practices, but it has “merely complemented” it with a “brief examination” of the effects produced by the contested practices on the national markets (paragraph 288, which is in open contrast to the paragraph 219, where the Court states that “the Commission, even though the case-law does not require it, also analysed, in the light of market conditions, the actual effects of the applicants’ practices”, analysis that as mentioned appears substantially limited in the text of the decision). Recalling the traditional case-law, the Court reminds once again that, in order to establish an infringement, it is not compulsory to prove that the abusive conduct causes a competitive impact on the relevant market, but it is sufficient to show that it “tends to restrict competition” or “is capable of having that effect” (paragraphs 288-28941). However, as mentioned, the capability of foreclosing is a characteristic typical of retroactive rebates, therefore such approach, being based on a competitive restriction by object, seems to be more form-based than effects-based42.

In the opinion of the Court, considered that the analysis realized by the Commission “merely complemented its finding of infringement”, some errors (although actually most of the graphs contained fundamental mistakes) in the same analysis cannot be used to invalidate its decision (paragraphs 268 and 290). The Court seems to mean that even a wrong analysis of the actual effects could not be used to confute the conclusions reached by the Commission in regard to the foreclosure nature of Tomra’s retroactive rebates. In fact it affirms that “the fact that the retroactive rebate schemes oblige competitors to ask negative prices from the applicants’ customers benefiting from rebates cannot be regarded as one of the fundamental bases of the contested decision in showing that retroactive rebate schemes are capable of having anti-competitive effects” (paragraph 258), statement that summaries and underlines how the evaluation of the two EU institutions is particularly distant from the price-cost test proposed in the Guidance Paper. Once again, the Court appears to attach more importance to the loyalty effect of the practice itself rather than to its actual capability of excluding competitors from the market, as demonstrated by the fact that the Court rejects entirely the Tomra’s proof regarding the absence of actual foreclosure and instead focuses only on the potential nature of the alleged conducts to foreclosure competition. Nonetheless, a such reasoning seems to be particularly worrying, since a dominant firm would be in any case incapable to prove the lack of actual effects and thus unable to contrast a finding of abuse.

41 The Court in the paragraph 288 of the judgement delivered for the Tomra case quotes the rulings rendered for the British Airways and Michelin II cases, where itself had already stated that: “The effect referred to in the case-law (...) does not necessarily relate to the actual effect of the abusive conduct complained of. For the purposes of establishing an infringement of Article [102 of the TFEU], it is sufficient to show that the abusive conduct of the undertaking in a dominant position tends to restrict competition or, in other words, that the conduct is capable of having that effect” (paragraph 239 of the Michelin II judgement which is conceptually equal to the paragraph 293 of the British Airways ruling).

42 Supra note 33, pp. 2.
5.2.4. Pro-Competitive vs Anti-Competitive Practices (Theory of Consumer Harm)

As a result, it appears clear that the Court does not fully address the complaint presented by Tomra, according to which a correct and proper foreclosure analysis should be necessarily based on a detailed economic-oriented examination, in line with the test proposed by the same Commission in the Guidance Paper. The Court affirms only in general terms that, foreclosing on average approximately 40 percent of the total demand and thus involving a substantial part of the market, the practices at issue were capable of reducing the number of rivals operating in the market. Therefore, an assessment of the circumstances and the context of the case, such as the one carried out at first instance, is enough to determine whether the practices of a dominant undertaking are capable of excluding competitors (paragraphs 242-243). In a subsequent paragraph, the Court seems to consider even possible to presume (despite it does not mean to ascertain) the exclusionary potential of a retroactive rebate simply taking into account a set of generic and qualitative elements typical of a rebate structure, such as its individualised and retroactive nature, as well as its application to a large portion of customers (paragraphs 260-261).

Contrary to this, as a preliminary, it is worthy to notice that, since in the EU competition law a market share below 40 percent is generally considered a safe proxy for the absence of a significant market power, in a case such as Tomra an effects-based analysis appears definitely more crucial than elsewhere. However, in the passages above-mentioned, the main concern derives from the exclusive focus on the capability of the practices of decreasing the number of competitors, which actually should be deemed only as a necessary but not a sufficient condition to judge the alleged conducts as anti-competitive. In fact, the risk is to make an erroneous distinction between pro-competitive and anti-competitive practices, as well as to safeguard a certain and existing market structure only because any its variation is presumed to cause a consumer harm, while instead it could be the result of a price competition between firms which would increase the general level of consumer welfare.

In the light of the critical assessment developed in the previous section (where it has been demonstrated that a standard predatory test would be not suitable in case of loyalty discounts), it is necessary to recognize that the Court in its judgement correctly asserts that a retroactive rebate granted by a dominant firm must not entail a profit sacrifice for being considered anti-competitive. The justification provided is that a loyalty discount can be spread over a large amount of units such as to allow the dominant firm to set an average price above cost (paragraph 267), statement which in turn seems to remind what declared by the Commission in its Guidance Paper (paragraph 39: “a conditional rebate granted by a dominant undertaking may enable it to use the non-contestable portion of demand of each customer [...] as leverage to decrease the

42 Supra note 37, pp. 140.
price to be paid for the contestable portion of demand\textsuperscript{3}, reasoning adopted as well in the Intel decision at the paragraphs 1005 and 1612). Thus, according to the Court, Tomra on one side has foreclosed part of its main competitors through the implicit setting of a very low incremental price, and on the other side has imposed its retroactive rebates on customers, resulting deprived of the possibility to benefit from the offers proposed by other competitors.

In this regard, the main criticism to the leverage effect theory has been the following one. It is certainly true that if a dominant firm grants a retroactive rebate spread on both the non-contestable and contestable portion of the customer’s demand, then the rival firm must match it only using the contestable share, offering an effective price lower than the discounted price. Anyway, this would not mean that the dominant firm has an absolute advantage on the contestable share, for which both firms set the same effective price, and that the resulting foreclosure does not entail a profit sacrifice (reason why, in order to condemn the allege conduct, it should be proved the possibility of a future recoupment)\textsuperscript{43}.

Nevertheless, as above shown, the main problem is not so much the leverage effect, but the impossibility for an as-efficient rival to reach its minimum efficient scale of production given the presence of a monopolized portion of demand, which can entail an anti-competitive foreclosure even though the dominant firm does not bear a profit sacrifice. Moreover, the leverage effect itself is not enough to deem the practices in question not only anti-competitive, but also leading to consumer harm. In fact, and in particular in a case such as Tomra where as often underlined the contestable portion of the customer’s demand was rather substantial, the presence of other rivals firm could be such to impede the dominant firm from engaging exclusionary conducts able to generate a consumer harm. Hence, in a such scenario, an incomplete and partial analysis could easily risk to cause a false-negative error, judging unlawful a conduct that instead is beneficial rather than harmful to consumers.

A part from this, although the two EU institutions seem rightly to not embrace a predatory theory of harm, on the other hand neither the Commission nor the Court has explicitly adopted a specific theory of competitive harm to evaluate the alleged conducts. The mere fact that around 60% of the total demand was fully contestable would have required, not only to carry out a complete effects-based analysis of the practices contested, but also an empirical assessment of the harm suffered by consumers, taking into account of course the approximations that a such evaluation would entail (among the lines of what realized in the Intel case, where, beyond the as-efficient competitor test, it has been provided abundant qualitative and quantitative evidence of consumer harm - cf. section 4.2.6 of the Commission Decision).

5.2.5. Serious Infringement vs Very Serious Infringement

Finally, even though the amount of the fine is rather small in comparison with those imposed in other cases, if its value is measured in proportion of the turnover of the firm, it constitutes the highest sanction ever levied for an abuse of dominant position in the EU case-law. It appears particularly significant therefore the fact that for a company which results only 57th in terms of dimensions in its country, as well as for a such narrow industrial sector, the Commission has decided to impose against a “serious infringement” a fine equal to 8 percent of the Tomra’s turnover, while in earlier cases it has decided to impose against a “very serious infringement” a fine equal, for instance, only to 1.5 percent of the Microsoft’s turnover (paragraph 305)\textsuperscript{44}.

Notwithstanding the Court reminds that fines imposed in other cases must not be considered source of comparison having a binding effect (paragraph 314), one could argue that, after the several criticisms received for the formalistic approach utilized in the past for fundamental cases in the field of loyalty discounts and rebates, through the Tomra case, the main intention of the Commission was to create a “textbook case” (as it has been defined by the same officers working in the case), in order to test what was previously proposed in the academic community, subsequently designed in the Discussion Paper and ultimately adopted in the Guidance Paper, although, as the present section has shown, its application has not been fully satisfied, being particularly distant from an analytical and quantitative approach\textsuperscript{45}.

5.3. Conclusions and Perspectives

The evaluation of Tomra’s retroactive rebates carried out by the Community institutions, despite results not based on a per se prohibition but tries to implement a sound economic methodology of analysis, still resembles to some extent the formalistic-legal approach that has characterized in the past decades the EU case-law, constantly leading to an artificial taxonomy and to a different interpretation of commercial practices with the same market effects. In fact, from a historical point of view, in the traditional case-law, the only form of rebate judged not entailing anti-competitive effects has been that one having an incremental application to standardised volumes of units, even though it was necessary to demonstrate the presence of cost savings or other efficiencies in the distribution phase\textsuperscript{46}.

In this context, the enforcement guidance offered by the Commission has certainly prospected a decisive and useful step towards a more solid economic background in the assessment of exclusionary practices. However, in the Tomra case, both the decision provided by the Commission and the subsequent

\textsuperscript{44} Supra note 33.
\textsuperscript{45} Supra note 34.
judgement by the Court underline how the EU institutions are still not completely disposed to leave behind the established case-law and to implement the policy reform of Article 102 of the TFEU, probably frightened in such evolution effort and transition process by the consistent workload that the new approach requires, as well as by the risk of more costly and lengthy administrative proceedings.

Nevertheless, all this cannot be the reason for not realizing a concrete estimation of the actual effects and consumer harm that an abusive conduct generates in a relevant market. Yet, it must be admitted that the economic reasoning at the base of the Torma case has probably been developed prior to the publication of both the discussion and guidance papers, and thus at a time where the as-efficient competitor test was only under discussion. Moreover, from a conservative perspective, one could argue that even today the price-cost test is suggested only as one possible priority setting line, but not as a compulsory tool.

In fact, running cases without implementing an as-efficient competitor analysis would still be compatible not only with the recent EU case-law, but also with Commission general policy, since the Guidance Paper is exactly a support document for internal priority setting purposes and it is not intended to represent a statement of law. Nonetheless, a such line of reasoning would risk to compromise the establishment of an effects-based assessment, which, beyond any doubt, appears always more necessary in the treatment of exclusionary abuses within the EU competition law.47

It is absolutely true that evaluating empirically the contestable portion of a customer’s demand, and more generally, the potential anti-competitive effects of an unilateral conduct results often particularly complex (as admitted by the Commission; Guidance Paper, paragraph 41: “The Commission will take into account the margin of error that may be caused by the uncertainties inherent in this kind of analysis”). However, an economic approach, even if not flawless, appears certainly more useful to distinguish between competitive and exclusionary conducts by dominant firms than a formalistic approach. In this sense, an as-efficient competitor test can definitely represent a helpful safe harbour, which should always be considered in any assessment involving loyalty schemes (Guidance Paper, paragraph 27: “If (...) the data suggest that the price charged by the dominant undertaking has the potential to foreclose equally efficient competitors, then the Commission will integrate this in the general assessment of anti-competitive foreclosure (...), taking into account other relevant quantitative and/or qualitative evidence”).

As a result, along the lines of the Intel case, where the Commission endeavoured to evaluate whether the rebates granted were capable of having a foreclosure effect on an as-efficient competitor, the hope is that also in future abuse of dominance cases the EU institutions will be disposed to adopt more explicitly an economic approach, as well as to rely more openly on the Guidance Paper.

References


References for Introduction to Loyalty Discounts and Rebates


