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Conditional pricing and the AEC test – A happy marriage or an awkward couple?

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ABSTRACT

In this article the question is investigated whether and when conditional pricing and the AEC test form a happy couple. In situations where rebates are used to dampen competition between incumbents or as an exploitative device, applying the AEC test does not make sense. However, in cases where the theory of harm is that rebates are being used as an exclusionary device, applying the AEC test is in principle useful to help distinguish between abusive and non-abusive conduct, while recognising that in some limited exclusionary conduct scenarios it does not make sense to create a safe harbour for pricing above cost. The article looks at which cost benchmark to apply and investigates possible practical difficulties of applying the AEC test, making a number of suggestions how to apply the test to different types of rebates.

Cet article examine si et quand les prix conditionnels et le test AEC (test du concurrent aussi efficace) forment un couple heureux. Lorsque les rabais sont utilisés pour freiner la concurrence entre opérateurs ou comme moyen d'exploitation, l'application du test AEC n'a aucun sens. Toutefois, dans les cas où la théorie du préjudice fait que l'on utilise les rabais comme moyen d'exclusion, l'application du test AEC s'avère utile, notamment pour distinguer les comportements abusifs de ceux qui ne le sont pas, tout en reconnaissant que, en certains cas de comportement d'exclusion limité, il n'est pas nécessaire de créer une zone de sécurité pour des ventes effectuées à des prix supérieurs aux coûts de production. Cet article s'intéresse aux coûts repère qu'il convient d'appliquer et explore d'éventuelles difficultés pratiques de la mise en oeuvre du test AEC, tout en posant des suggestions sur la manière d'appliquer le test à différents types de rabais.

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Conditional pricing and the AEC test – A happy marriage or an awkward couple?

I. Introduction: The *Intel* and *Post Danmark* judgments

1. The judgments of the Court of Justice¹ in *Post Danmark*² in 2012 and *Intel*³ in 2017, in both cases sitting in Grand Chamber, are decisive steps in the development of a coherent effects-based approach to European Union (“EU”) competition law and to the application of Article 102⁴ in particular. To introduce this article, I will highlight what I see as the key elements of these two judgments.⁵ I will then address the main issue of this article: in what circumstances the as-efficient-competitor (AEC) test is useful for the assessment of rebates.

2. The first key element of the two judgments is the Court’s confirmation that the aim of EU competition law is to enhance consumer welfare by protecting competition. Following what it had already said in *Continental Can*,⁶ in *Post Danmark* the Court clarified: “*It is apparent from the case-law that Article 82 EC [now Article 102 TFEU] covers not only those practices that directly cause harm to consumers but also practices that cause consumers harm through their impact on competition (...)* It is in the latter sense that the expression ‘exclusionary abuse’

1 Court of Justice of the European Union (hereafter “the Court” or “the ECJ”).

2 Case C-209/10 *Post Danmark A/S v. Konkurrenceerådet*, judgment of 27 March 2012, ECLI:EU:C:2012:172.

3 Case C-413/14 P *Intel v. Commission*, judgment of 6 September 2017, ECLI:EU:C:2017:632. I only deal with the first ground of the appeal in *Intel*, i.e., that the General Court erred in law by failing to examine the rebates at issue in the light of all the relevant circumstances, and not the procedural and jurisdictional grounds of appeal.

4 Article 102 of the Treaty on the Functioning of the European Union (hereafter “Article 102”).

5 For a selection of the articles and discussions these two judgments have led to, see the references to articles (“Notes on Academic Writings”) under the “case information” button on the pages for the judgments on the Curia website, which can be found respectively at <http://curia.europa.eu/juris/liste.jsf?num=C-209/10&language=EN> and <http://curia.europa.eu/juris/liste.jsf?num=C-413/14&language=EN>

6 Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v. Commission*, judgment of 21 February 1973, ECLI:EU:C:1973:22, para. 26.

appearing in the questions referred is to be understood.”⁷ This is important because for an effects-based approach it is necessary that the impact of a firm’s conduct on the goal which competition policy seeks to attain is—at least in theory—objectively measurable. This is indeed the case for consumer welfare, whereas it is not for the competitive process.

3. The second key element is the Court’s clarification in *Intel* that the legal presumption, present in the case law since *Hoffmann-La Roche*,⁸ that exclusivity rebates and more generally exclusive dealing by a dominant firm constitute an abuse of its dominant position, must from now on, at least for exclusivity rebates, be read as being rebuttable. If the dominant firm “submits, during the administrative procedure, on the basis of supporting evidence, that its conduct was not capable of restricting competition, and, in particular, of producing the alleged foreclosure effects,”⁹ the enforcing authority will be required to apply the effects-based approach set out in the following paragraph of the judgment, i.e., to substantiate the likely or actual negative effects.

4. It is in paragraph 139 of the *Intel* judgment that the Court spells out in more detail the effects-based approach that must be applied to assess the possible negative effects of exclusivity rebates, once the dominant firm has rebutted the presumption. The factors that are mentioned, such as the extent of the dominant position and the degree of market coverage of the conduct, indicate that a fully-fledged assessment of the effects is required. Once the dominant firm has rebutted the presumption, exclusivity rebates now need to be assessed as a “by effect” conduct and not as a “by object” conduct. This effects-based approach brings a much-needed coherence to the application of Article 102 and Article 101, since, under Article 101, exclusivity-based obligations are traditionally assessed as “by effect” restrictions.¹⁰

5. This coherence does not mean that the assessment of the possible negative effects of exclusivity rebates is exactly the same under Articles 101 and 102. Under Article 101, there is no rebuttable presumption that such conduct restricts competition, while under Article 102 there is a rebuttable presumption that such conduct constitutes an abuse.¹¹ However, by turning the legal presumption into a rebuttable presumption, the Court ensures that also under Article 102 it is necessary first to assess the possible negative effects, before assessing whether there are possible countervailing efficiencies.

7 *Post Danmark*, cf. footnote 2, para. 20.

8 Case C-85/76 *Hoffmann-La Roche v. Commission*, judgment of 13 February 1979, ECLI:EU:C:1979:36.

9 *Intel*, para. 138. The Court’s statement that its previous case law “must be further clarified” is a euphemism for amending and partly overruling its previous case law.

10 For more arguments, see my article *Coherence in the Application of Articles 101 and 102: A Realistic Prospect or an Elusive Goal?* *World Competition*, September 2016, Vol. 39/3, in particular section 8.

11 Placing the burden of rebuttal on the dominant firm under Article 102, whereas, under Article 101, the burden of proving a restriction rests entirely on the enforcing authority or plaintiff, may be a way of the Court to recognise the special responsibility borne by a dominant firm, i.e., to take into account that its conduct, because of its strong position on the market, has a higher potential to have negative effects.

6. Thirdly, and related to the previous element, it is coherent to limit the “by object” category to types of conduct that are devoid of any credible efficiency rationale, as already described in the Article 102 Guidance Paper¹² and subsequently referred to in the *Intel* decision as “naked restrictions.” An example of this type of “by object” conduct is where a dominant firm makes payments to its customers to halt or delay the launch of products by these customers which incorporate the products of a competitor of the dominant firm. This type of conduct was one of the constituents of the abuse of dominance found in the *Intel* decision. For these types of “by object” conduct, there is a legal and non-rebuttable presumption that the conduct will result in a restriction of competition and will have negative effects, so that the only way for the dominant firm to escape liability is to show counterbalancing efficiencies.¹³

7. As already indicated at the end of the previous paragraph, a fourth necessary element of an effects-based approach is that not only negative but also positive effects should be taken into account. The Court acknowledged this in *Post Danmark* by aligning, for the first time, the conditions for a successful efficiency defence under Article 102 with those under Article 101(3), and enumerating all the conditions for a successful efficiency defence in the same way as the Commission had already done in its Article 102 Guidance Paper.¹⁴ Before *Post Danmark*, it was unclear whether efficiencies could be taken into account under Article 102 and, if so, how that should be done.

8. A fifth helpful element for a coherent application of the effects-based approach is that the Court has demystified the vague expression that “dominant firms have a special responsibility to only compete on the merits.” By stating that “competition on the merits may, by definition, lead to the departure from the market or the marginalisation of competitors that are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation” (respectively para. 22 and 134 of *Post Danmark* and *Intel*), the Court equates competition on the merits with conduct that does not harm consumers. This implies that the special responsibility borne by dominant firms is nothing other than the responsibility not to harm consumers by reducing competition, i.e., to take into account, when they determine their commercial strategy, that their position of economic strength means that their conduct and agreements are more likely to have anti-competitive effects.¹⁵

12 Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (Article 102 Guidance Paper), OJ C 45/7 of 24.2.2009, para. 22.

13 For more arguments, see my article *Coherence in the Application of Articles 101 and 102: A Realistic Prospect or an Elusive Goal?* *World Competition*, September 2016, Vol. 39/3, in particular sections 6–8. If a dominant firm combines “by object” and “by effect” conduct, the non-rebuttable presumption should apply to the combined conduct.

14 Para. 40–42 of the judgment and para. 30 of the Article 102 Guidance Paper. In *Post Danmark*, the Court’s description of the efficiency defence follows the Article 102 Guidance Paper almost word for word.

15 See also footnote 11.

9. A sixth element is that the Court, both in *Post Danmark* and *Intel*, subscribes to the common view that it is pressure on competitors that breeds competition, innovation and excellence, while protection will only lead to rent-seeking behaviour and undermine the incentives to compete: “It is in no way the purpose of Article 102 TFEU to prevent an undertaking from acquiring, on its own merits, the dominant position on a market. Nor does that provision seek to ensure that competitors less efficient than the undertaking with the dominant position should remain on the market.”¹⁶ This is appropriate because protecting inefficient competitors, or at least competitors showing no promise of becoming efficient, against competition is not only bad for consumers but also for the economy in general, as it hampers the efficient reallocation of factors of production. This can be termed the as-efficient-competitor (AEC) principle.

10. Seventhly, the Court has adopted a coherent approach to pricing conduct. The Court showed in *Post Danmark*—and in earlier cases such as *AKZO*¹⁷—that it has understood that, as regards pricing conduct, only pricing which is objectively too low can foreclose and harm competition. It is generally not possible to foreclose as-efficient rivals by charging a price above cost. This has led to the adoption of a price-cost test—the as-efficient-competitor test (AEC test)—in predation and margin squeeze cases.¹⁸

11. The frequent references in the *Intel* judgment to the AEC principle¹⁹ show that the Court considers that, as regards pricing conduct, the logic that only prices which are objectively too low can foreclose and harm competition holds not only if the dominant firm charges a uniform low price to some or all of its customers, but also if the dominant firm offers the low price through a rebate arrangement only for a certain part of a customer’s demand or only in return for exclusivity. The Court does not follow the General Court’s attempt to distinguish the *Intel* case from *Post Danmark* and to draw from that distinction the conclusion that exclusivity rebates (and more generally conditional pricing) are not about pricing.

12. The seven elements highlighted above provide a firm basis for a coherent effects-based approach under Article 102. While some issues remain unresolved and debate is likely to continue on several aspects of the *Intel* judgment, this should not cloud our appreciation of the significance of the *Intel* and *Post Danmark* judgments as decisive steps in the development of a coherent effects-based approach to EU competition law.

16 Para. 21 of *Post Danmark* and para. 33 of *Intel*.

17 Case C-62/86 *AKZO Chemie BV v. Commission*, judgment of 3 July 1991, ECLI:EU:C:1991:286.

18 For a similar distinction between AEC principle and AEC test, see R. De Coninck, The as-efficient competitor test: some practical considerations following the ECJ *Intel* judgment, *Competition Law & Policy Debate*, Vol. 4, Issue 2, June 2018, pp. 73–80, in particular footnote 2.

19 Para. 133, 134, 136, 139 and 140 of the judgment.

II. Outline of this article: An attempt to resolve some of the outstanding issues

13. One outstanding issue concerns the practical consequences of the Court’s clarification in paragraph 138 of *Intel* that the legal presumption—found in the case law since *Hoffmann-La Roche*—that exclusivity rebates constitute an abuse must from now on be read as a rebuttable presumption. It will be important to determine the level of the threshold for the dominant firm to shift the evidential burden to the authority. The wording used by the Court (“submits, during the administrative procedure, on the basis of supporting evidence, that its conduct was not capable of restricting competition, and, in particular, of producing the alleged foreclosure effects”) indicates that the dominant firm must at least provide case-specific arguments and/or evidence that cast sufficient doubt on the otherwise presumed capability of its conduct to foreclose as efficient competitors.

14. I will not try to resolve this issue in this article. In practice, the level of the threshold which the dominant firm must reach in order to shift the burden of proof to the enforcing authority, may prove to be a somewhat academic question. Most authorities may not want to prepare a draft negative decision based only on the negative presumption because it can be expected that dominant firms will generally seek to rebut the presumption. In case of rebuttal, the enforcing authority would then be required to adopt a second draft negative decision, setting out its assessment of the actual or likely negative effects. In the interest of limiting the length of the enforcement procedure, it seems more likely that authorities will wish to show upfront, at least in a qualitative way, that the conduct is likely to harm competition and consumers.²⁰

15. Secondly, it will be necessary, again in future cases, to clear up whether *Intel* overrules and replaces *Post Danmark II*.²¹ The emphasis placed by the *Intel* judgment on the AEC principle seems to indicate that pricing conduct can only be abusive if it is capable of excluding as efficient competitors. This could be interpreted to mean that pricing conduct can only be abusive if the

20 See also J. L. da Cruz Vilaça, The intensity of judicial review in complex economic matters—recent competition law judgments of the Court of Justice of the EU, *Journal of Antitrust Enforcement*, 2018, Vol. 6, Issue 2, p. 183, where this judge of the ECJ says as regards the competitive assessment of systems of exclusivity rebates: “I think the regulator would be well advised in the future not to expect any special indulgence for relying on a presumption of any kind of infringement per se of Article 102 TFEU when seeking to prove the anticompetitive character of such a system.”

21 Case C-23/14 *Post Danmark AIS v. Konkurrencerådet*, judgment of 6 October 2015, ECLI:EU:C:2015:651.

price, however measured, is below the dominant firm's own costs. On this interpretation, pricing above cost would never be abusive, whereas in *Post Danmark II* the Court clearly allowed for the possibility of finding an abuse where the conditional pricing was above cost. In that case, the Court referred to the legal monopoly held by Post Danmark before liberalisation and which made it difficult, if not impossible, for entrants to become as efficient as the dominant firm.²²

16. The answer to this second outstanding question—in which situations it may be justified to protect less efficient competitors—will depend on a balancing of the aim of effectively protecting competition with the need to ensure an adequate level of legal certainty. In this article, I describe certain circumstances in which it may be justified to intervene to protect (currently) less efficient competitors. These circumstances are closely aligned with but also expand upon what is described in the Article 102 Guidance Paper as a dynamic approach to the AEC principle. This approach allows for demand-related advantages of the dominant firm to be discounted.²³ I argue for intervention that would at least respect the AEC principle.

17. The main focus of this article will be to try to provide answers, or at least some insights, in relation to a third outstanding issue: in what circumstances the AEC test is useful for the assessment of rebates. The debate on this issue currently lacks a certain refinement, with opinions ranging from “*useful and to be used where reliable data are available*” to “*useless because too difficult to apply in practice.*”²⁴

18. This third issue is addressed by raising and answering a number of questions, from more general and theoretical to more practical and specific. In this article the terms “conditional pricing” and “(conditional) rebates” are used interchangeably. Conditional rebates mean that prices are set at a certain level to reward a particular purchasing behaviour, which usually consists of reaching a certain purchasing threshold in a particular period. If the rebate is granted on all purchases once the threshold is reached, it is called a “retroactive rebate.”²⁵ If the rebate is only granted on the purchases made in excess of those required to achieve the threshold, it is called an “incremental rebate.” In both cases, the price is conditional on the purchasing behaviour of the buyer, i.e., a rebate is a form of conditional pricing.

19. The manner in which the Court incorporates the AEC principle in the list of factors to be addressed under the effects-based approach, in paragraph 139 of *Intel*, by requiring the authority “*to assess the possible existence*

of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking,” suggests that the Court recognises that applying the AEC test in conditional rebate/conditional pricing cases may not always be straightforward and that therefore it is better to leave the enforcing authority discretion as to how it shows that the conduct in question is capable of foreclosing as efficient competitors and, in particular, in which cases to apply the AEC test.²⁶ To some extent, the Court had already addressed this question in *Post Danmark II*, a case about a standardised retroactive rebate scheme applied by Post Danmark, in which the Court ruled that the application of the AEC test is not a necessary condition for finding an abuse in a rebates case, but rather a useful tool.²⁷

20. This flexible approach to the application of the AEC test recognises that where competitors cannot compete for a customer's entire demand (“competition for the customer”) but are only able to compete for part of a customer's demand (“competition for the contestable part of customer demand”), this affects the calculation of the effective price a competitor will have to offer in order to match the conditional rebate and convince customers to switch part of their demand. If a price-cost test is to be applied in this type of case, a more sophisticated and arguably more cumbersome AEC test is required than the one applied in cases of predation. It would require an AEC test such as the one developed in the Article 102 Guidance Paper, meant for conditional rebates granted by dominant firms that are an unavoidable trading partner, as was applied by the Commission in its *Intel* decision.

21. In summary, to reach a better understanding of the role the AEC test can play, it may be helpful to distinguish between situations where rebates are used as an exclusionary device, in which case the AEC test is in principle useful (section IV), and situations where rebates are used to dampen competition between incumbents or as an exploitative device, in which case it does not make sense to apply an AEC test (section III). In the first type of situation (exclusionary conduct), it would also make sense to take into account the possible practical difficulties of applying the AEC test. These difficulties depend partly on the type of rebate, in particular whether it concerns an incremental rebate or an (individualised) retroactive rebate (section V).

²² Para. 59 and 60 of *Post Danmark II*.

²³ See section III.C of the Article 102 Guidance Paper, in particular para. 24.

²⁴ In discussing when it is useful to apply the AEC test, the article touches upon requirements under the case law, but without trying to give a legal answer.

²⁵ In the USA retroactive rebates are often referred to as loyalty discounts, all-units discounts or cliff discounts.

²⁶ However, the *Intel* judgment makes clear that where an authority does apply the AEC test, the reviewing court must examine any claims by the dominant firm that the authority has made errors in applying the test.

²⁷ Para. 61 and 62 of *Post Danmark II*.

III. Conditional rebates used to exploit or collude: Where it does not make sense to apply the AEC test

22. At the highest level, there are three possible theories of harm under Article 102. Conduct by a dominant firm can be harmful because the firm exploits its market power to directly harm consumers (exploitative conduct).²⁸ Conduct by a dominant firm can also be harmful to consumers because it limits competition. The latter can be the result either of the conduct having an exclusionary effect (exclusionary conduct) or of the conduct having a collusive effect (collusive or competition dampening conduct).

23. As regards the use of rebates as a form of exploitative conduct, there is literature which indicates that rebates can be used by a dominant firm to apply first- and/or second-degree price discrimination and thereby to increase prices and convert consumer surplus into producer surplus.²⁹ In essence, these models show that, if entry of competitors is not an issue, a monopolist can use rebates to deprive customers of customer surplus that would have been available to the customers had the monopolist simply applied a uniform monopoly price.³⁰ For instance, an incremental rebate scheme could be used to demand a higher price for the first units, for which the customer has a higher willingness to pay, and a lower price for additional units, where the willingness to pay is lower. In such cases, the theory of harm would be that the price discrimination leads to an exploitative abuse.³¹

28 It is common in competition law for the concept of “consumers” to encompass all direct or indirect users of the products affected by the conduct, including intermediate producers that use the product as an input, as well as distributors and final consumers. See for instance the Article 102 Guidance Paper, para. 20.

29 See E. Elhauge, Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory, *Harvard Law Review*, Vol. 123, No. 2, December 2009, and N. Economides, Tying, Bundling, and Loyalty/Requirement Rebates, in *Research Handbook of the Economics of Antitrust Law*, E. Elhauge (ed.), Edward Elgar, 2012. A good example of a paper that could be relevant in a case of exploitative conduct but where conclusions are drawn for exclusionary conduct is F. Maier-Rigaud and U. Schwalbe, Do Retroactive Rebates Imply Lower Prices for Consumers? Document de travail du LEM, 2013-11. In their model about a monopolist’s pricing, entry is assumed impossible and competition and exclusion are thus not an issue. Nonetheless the resulting possibility to apply first- and second-degree price discrimination with the help of rebates is used as “proof” that, in cases where foreclosure is the issue, such rebates will also lead to higher prices and consumer harm.

30 “Customers” and “customer surplus” are used here as often these rebates are offered by the dominant firm to professional buyers, such as producers and distributors further downstream. But see footnote 28.

31 On discrimination and exploitation, see my chapter Price Discrimination and Exploitation, in the *Annual Proceedings of the Fordham Competition Law Institute*, Barry E. Hawk (ed.), Fordham Competition Law Institute, 2009.

24. In the case of exploitative conduct, it does not make sense to apply the AEC principle or the AEC test. The question of whether the price charged by the dominant firm is below cost, in general or over a part of its supply, is the wrong question to ask when assessing whether the pricing of the dominant firm is too high and constitutes an exploitative abuse.

25. The same conclusion applies in cases where rebates are used as a device to facilitate (tacit) collusion. In the recent economic literature about retroactive rebates, various groups of models can be distinguished. One group of models can be named “competition dampening” or “tacit collusion” models.³² What these models have in common is that they show that retroactive rebates can be used to dampen competition between the incumbent dominant firm and a rival firm, whether already present on the market or a new entrant.³³

26. The models show that such dampening of competition is possible if the dominant firm employs a retroactive rebate scheme with a threshold that leaves a sufficient share of the market to the competitor. A rebate scheme with a threshold which is set, for instance, at 60% or 80% of customers’ demand will create a loyalty-enhancing effect in particular just below the threshold, while maintaining a relatively high price above the threshold.³⁴ The competitor is now put in the position of choosing either to compete for demand below the threshold, which will require low pricing to overcome the rebate, or to accommodate and settle for the remaining 40% or 20% of the market while being able to charge a high price itself. If a sufficient share of the market is left to its competitor, the dominant firm’s retroactive rebate scheme helps to reduce the incentive of the rival to compete on price. To strengthen the competition-dampening effect, the rival may also apply a retroactive rebate scheme, with its threshold mirroring the threshold of the dominant firm’s rebate scheme. This would also make it costly for the dominant firm to sell beyond its own threshold. In other words, the theory of harm in such a case is not about exclusion but about dampening of competition.

27. A strategy to dampen competition will, of course, only be successful if the dominant firm leaves sufficient space to the competitor and makes it attractive for the latter to choose not to compete for demand below the threshold. Such a case will generally feature a competitor

32 See for instance R. Inderst and G. Shaffer, Market-Share Contracts as Facilitating Practices, *RAND Journal of Economics*, Vol. 41, No. 4, Winter 2010, pp. 709–729; E. Elhauge and A. Wickelgren, Robust Exclusion and Market Division through Loyalty Discounts, April 2014, paper presented at the FTC/DOJ workshop on Conditional Pricing Practices, June 2014; M. A. Salinger, Anticompetitive Cliff Discounts by a Dominant Producer Threatened by Partial Entry, June 2014, paper presented at the FTC/DOJ workshop on Conditional Pricing Practices, June 2014.

33 Note that incremental rebates are generally not capable of being used as a device to dampen competition. An incremental rebate can only be used to dampen competition in case the rebate, kicking in above a particular threshold of purchases, would cease to be granted for purchases by the customer above a second, higher threshold. Purchases above this second, higher threshold would thus be left to a competitor. As such rebate schemes have not been found in practice, this theoretical exception is not further developed in this article.

34 Such a threshold can be set either by explicitly specifying a percentage of total purchases, or, in particular when demand is predictable, by specifying a required volume or turnover.

which does not complain, because it is content with the resulting high prices and high profits, but customers that may complain, as a result of high prices. Where there is more than one competitor to the dominant firm, such a competition-dampening strategy is unlikely to work, if only because the competitors would need to be able to overcome the coordination problem between themselves and avoid competing fiercely for market share also between themselves.

28. In cases where the theory of harm is that the retroactive rebate scheme of the dominant firm is likely to dampen competition, it does not make sense to apply the AEC principle or the AEC test. The dampening of competition and the harm to consumers is not dependent on the effective price being below cost or the competitor being as efficient.

IV. Conditional rebates and foreclosure: Where in principle it does make sense to apply the AEC test

29. Where the theory of harm is that the conditional rebate scheme of the dominant firm is likely to have an exclusionary effect, by foreclosing competition, it generally makes sense to apply the AEC principle and, by extension, in principle it makes sense to apply the AEC test. For cases involving pricing conduct, the test is instrumental to help us distinguish between an intervention which will protect competition and consumers, and an intervention which would merely protect less efficient competitors while denying consumers the benefit of competition and lower prices driven by rebates.

30. As already summarised in section I above, in *Post Danmark* and *Intel*, the ECJ seems to adhere to the commonly held view that it is pressure on competitors which breeds competition, innovation and excellence, while the protection of competitors will only lead to rent-seeking behaviour and undermine the incentives to compete. Protecting inefficient competitors against competition is not only bad for consumers but is also bad for the economy as a whole, as it hampers the efficient reallocation of factors of production.³⁵ In *Post Danmark*, and in earlier cases such as *AKZO*, the ECJ showed that it well understands that, as regards pricing

conduct, only pricing which is too low can foreclose and harm competition. It is generally not possible to foreclose efficient rivals by charging a price above cost.

31. This logic—that in cases involving pricing conduct only pricing which is too low can foreclose and harm competition—holds not only where the dominant firm simply charges a low price to all customers, but also where the dominant firm offers the low price only to certain customers, or only for a certain share of customers' demand, or only in return for exclusivity. Rebates can be used to foreclose, but only by lowering the price for marginal sales. One reason why rebates can be attractive to (dominant) firms is that they allow the firm to lower its price selectively for those customers, or that share of a customer's demand, for which competition is most fierce. This may allow the dominant firm to compete without having to lower its price for all demand/all customers. However, the way that competition takes place is nonetheless by lowering the price for the part of demand where competition is fierce and this does produce a direct customer benefit. If we prohibited rebates without investigating whether the price is competitively low or too low (below cost), we run the risk of depriving customers of the benefit of lower prices offered by the dominant firm for the share of demand where customers are willing and able to switch.

32. The form of the pricing conduct—a general price cut for all demand or a more targeted price cut for only a part of demand—matters for a more refined theory of harm, as it will influence the likelihood that the pricing conduct is used to foreclose and/or create efficiencies. The more general the price cut, the more costly it will be and consequently the less likely that it will be part of a rational foreclosure strategy. The more the price reduction can be targeted at only a part of demand, i.e., the more the pricing conduct can be differentiated for different parts of demand, the less costly it may be to foreclose.³⁶ The same applies for the likelihood of creating efficiencies: the better targeted the conduct is, the higher the potential to achieve efficiencies. However, these distinctions do not affect the logic for applying the AEC principle and by extension the AEC test whenever the conduct involves (conditional) pricing and the overall theory of harm is about foreclosure.

1. In principle means not always, so what are the exceptions?

33. Saying that it makes sense in principle to apply the AEC test implies that there are exceptions. So, what are the situations, where the conduct involves conditional pricing and the theory of harm is about foreclosure, where it does not make sense to use the AEC test? As far

³⁵ The General Court in *Intel* seemed to hold a different view: that the level of the rebate or the resulting price do not matter, and that it is only the conditionality that matters. Case T-286/09 *Intel v. European Commission*, in particular para. 107–109 and 150–152.

³⁶ See also C. Fumagalli and M. Motta, On the Use of Price-Cost Tests in Loyalty Discounts and Exclusive Dealing Arrangements: Which Implications from Economic Theory Should Be Drawn?, *Antitrust Law Journal*, Vol. 81, Issue 2, 2017, in particular pp. 557–559 and 565–569.

as I can see—but others may be able to identify additional scenarios—there are roughly three such situations.

34. The first situation is where the conduct in question, while involving a discount, is not in fact conditional pricing, i.e., not a real rebate system. In the case of a real rebate system, instead of taking the rebate offered by the dominant firm in return for purchasing more, the customer has the alternative of purchasing less from the firm and foregoing the rebate. If buyers are effectively barred from buying less at the higher/non-rebated price, it will not be a real rebate system. This is the case for single branding/exclusive purchasing obligations, where the only alternative to accepting the rebate and higher purchase requirement is to purchase nothing at all from the dominant firm.³⁷ If that is the case, the conduct is not a form of pricing conduct, even though a discount is involved. Rather, it is a requirement to purchase a certain minimum amount, or to purchase exclusively from the dominant firm.³⁸

35. Whether or not the dominant firm is in fact willing to supply a lesser amount at the higher price is a factual question. Is the dominant firm in fact allowing customers to forego the rebate and buy less at the higher price, or does it refuse to supply less at the higher price, or delay such supplies or otherwise make it impossible or unattractive for the customer to purchase less from it?³⁹ In the second scenario, the conduct is better defined and dealt with as a single branding/exclusive purchasing obligation sweetened by a rebate, in which case it would not make sense to apply the AEC test.

36. The second situation is where the competitor of the dominant firm is only a potential competitor or recent entrant which is not yet able to make credible offers to customers. If customers fear that in due course the entrant may not be able to deliver, for instance because it has not yet obtained sufficient demand to enter or stay in business, they could be persuaded to buy exclusively from the dominant firm, even though the rebate is only minimal. The customer might do so in order to avoid the risk of not being able to fulfil all its requirements or being forced to purchase the remainder from the dominant firm at a higher, non-rebated price. For this fear to be realistic, there must be a coordination problem between

the customers: the entrant's offers must lack credibility unless a certain number of customers have committed to purchase from it, and each customer must be too small for its individual demand, on its own, to make the entrant a credible supplier.⁴⁰

37. In such a situation, an equally efficient entrant may be foreclosed, not because the dominant firm's effective price is so low as to make entry commercially unviable, but because customers are afraid to commit to buying from the entrant due to the risk of not being able to obtain (sufficient) supplies in case the entry does not materialise. In that case, it would not make sense to apply the AEC test.

38. In these first two situations, it is not conditional pricing that leads to the foreclosure. While there is a pricing element, the foreclosure results from other factors: in the first situation, from the exclusive purchasing obligation, and in the second, from the inability of the entrant to make a credible offer and of individual customers to solicit a credible offer.

39. The third situation concerns the so-called “naked exclusion models,” which show that, in cases where the dominant firm benefits from significant economies of scale, pricing above cost may also be harmful to consumers.⁴¹ This does not necessarily mean that the AEC test should not be applied in such cases, but rather that it should not be used to create a safe harbour for above-cost pricing. In cases where a competitor must win a significant proportion of the market in order to achieve significant economies of scale, the dominant firm may be able, by using a sufficiently high threshold in its rebate scheme, to keep the competitor small and thereby increase its costs, and thus possibly exclude it, while pricing above its own cost (as its own costs may be lower as a result of it having already achieved the necessary economies of scale). Note that intrinsically the competitor may be as efficient as (or possibly more efficient than) the dominant firm. It may be on the same (or possibly lower) cost curve as the dominant firm, but its actual costs are higher because it is currently producing below the minimum efficient scale.⁴²

³⁷ The terminology used for obligations to purchase all or most requirements from the supplier varies. Such requirements are referred to as “single branding” in the Commission Guidelines on Vertical Restraints and as “exclusive purchasing” in the Article 102 Guidance. In the US, this is captured under the wider category of exclusive dealing.

³⁸ Stated differently, in the case of a single branding/exclusive purchasing obligation, there is a commitment on the part of the buyer to purchase only from or at least a particular amount from the supplier, whereas in the case of a rebate scheme, there is a commitment on the part of the supplier to offer different prices depending on how much the buyer purchases. See also C. Fumagalli and M. Motta, On the Use of Price-Cost Tests in Loyalty Discounts and Exclusive Dealing Arrangements: Which Implications from Economic Theory Should Be Drawn?, *Antitrust Law Journal*, Vol. 81, Issue 2, 2017, in particular p. 539.

³⁹ In many cases, it may be clear that the conduct in question is a real rebate system, in particular if the customer is obtaining supplies and paying the higher price until it has reached, in the period of reference, the relevant threshold, upon which it receives the rebate as a cashback. However, in cases where the buyer has to indicate upfront how much it intends to purchase, a possible threat from the supplier not to supply unless the order reaches a particular threshold will have to be investigated for its credibility, as the supplier will generally have an incentive to renegotiate and supply less at a higher price.

⁴⁰ See Elhaug & Wickelgren referred to in footnote 32. In their model, there is yet another possibility to exclude equally efficient competitors with pricing above cost, which however is not linked to the rebate scheme but to the condition that customers have to decide to accept the rebate and exclusivity before they are allowed to obtain offer(s) from competitor(s). In that situation, where customers have to choose without knowing the alternatives, they may fear that if insufficient customers choose to buy from the competitor(s), the latter may not enter or stay on the market or may choose to also charge a high price as a result of the dampening of competition. What is however at stake here is the competition assessment of a condition that does not allow customers to obtain binding offers from competitors before agreeing with the dominant firm. Such conduct is not pricing conduct in the true sense and is probably best assessed as a variation of the “by object” restrictions already mentioned in point 22 of the Article 102 Guidance Paper.

⁴¹ See for instance E. B. Rasmusen, J. M. Ramseyer and J. S. Wiley, Naked Exclusion, *American Economic Review*, Vol. 81, No. 5, 1991, pp. 1137–1145; I. R. Segal and M. D. Whinston, Naked Exclusion: Comment, *American Economic Review*, Vol. 90, No. 1, 2000, pp. 296–309; C. Fumagalli and M. Motta, Exclusive Dealing and Entry, when Buyers Compete, *American Economic Review*, Vol. 96, No. 3, 2006, pp. 785–795.

⁴² For the concepts involved, see The Economics of Competition, L. Peepkorn & V. Verouden, chapter 1 and in particular section 2 thereof, in *The EU Law of Competition*, Faull & Nikpay (eds.), third edition, 2014.

40. This is a special situation but not necessarily an uncommon one, as illustrated by the judgment of the ECJ in *Post Danmark II*. In its judgment, the Court observed that because of *Post Danmark's* legal monopoly over part of the market, it was very difficult, if not impossible, for entrants to become as efficient.⁴³ As mentioned in section II of this article, the Article 102 Guidance Paper already provides for a dynamic approach to the as-efficient-competitor principle, by allowing demand-related advantages of the dominant firm, such as network effects, to be taken into account.⁴⁴ It could be argued that this should be extended to all economies of scale. This would allow a finding of anti-competitive foreclosure to be made even though the rebated price remains above the costs of the dominant firm.⁴⁵

41. However, this does require a finding that economies of scale are indeed an important feature of the market concerned, that the relevant competitors are currently below minimum efficient scale and that the number of customers is high enough for there to be a coordination problem between them. In this type of scenario, there may be a good reason to intervene against the rebate scheme of a dominant firm, even though it cannot be shown that the effective price is below cost. Applying a price-cost test may nonetheless be useful: if the price is only marginally above cost, it is more likely that the rebate scheme is responsible, in combination with the deprivation of economies of scale, for anti-competitively foreclosing competitors, whereas such a conclusion may not be justified where the effective price is well above cost, in particular if the economies of scale are modest.

2. In the absence of economies of scale, can pricing above cost ever harm consumers?

42. It is not difficult to give a theoretical example of pricing above cost that may foreclose competitors to the detriment of consumers, even where the foreclosure does not result from preventing the competitors from achieving certain economies of scale. There are basically two scenarios found in the literature.

43. The first scenario is where the dominant firm is more efficient than all of its competitors, but is still (marginally) constrained in its pricing by these less

efficient rivals. Consider a market where the monopoly price per unit is €80, the dominant firm's costs are €50 per unit and the per unit costs of its competitors are €70. Competition with its competitors is leading to a market price around €70. If the dominant firm lowered its price to €60, it could drive its competitors from the market. After their exit and having built a reputation for not allowing others into the market, the dominant firm (now monopolist) may be able to raise the price to €80. In this scenario, it could be argued that competition policy should prevent the dominant firm from reducing its price to €60, whether through a uniform price cut or by means of a rebate scheme. This would protect consumers against the subsequent increase in price to €80.

44. There are two problems with intervening in this first scenario. First, it would create legal uncertainty for dominant firms—how are they expected to know their competitors' costs in order to avoid the risk of an intervention? This is one reason why the European courts generally require price-cost tests to be based on the dominant firm's own prices and costs. Second, intervening in this scenario might undermine the incentive of competitors to become more efficient. As mentioned at the start of section IV, in *Post Danmark* and *Intel*, the ECJ seems to adhere to the common view that it is pressure on competitors that breeds competition, innovation and excellence, while protecting competitors can be expected to lead to rent-seeking behaviour and to undermine the incentives to compete.

45. The second scenario is put forward by those who argue that a retroactive rebate scheme is like a tax on the possibilities of rivals to compete.⁴⁶ The rebate scheme may not make it impossible for rivals or a rival to compete for a (very) significant share of the market, but it makes it less attractive to compete fiercely and makes it more attractive to stay in a small part of the market or market niche. It is argued that the dominant firm's rebate scheme, like a tax, reduces the incentive of its rival(s) to compete and this can be expected to harm consumers. Competition law should prohibit such conduct and because a reduction of the incentive to compete does not depend on the effective price being below cost, finding such an abuse would not and should not require the application of the AEC principle or AEC test.

46. The problem with intervening in this second scenario is that there appears to be no practical principle by which to limit the scope of application of competition law in cases where the effective price remains above cost. While some would group this scenario together with other scenarios involving the raising of rivals' costs, this second scenario is fundamentally different from the naked exclusion models based on the existence of significant economies of scale discussed in the previous subsection. Where rivals are prevented from achieving economies of scale, it is in principle possible to estimate how much their costs are raised by the conduct of the dominant firm.

43 See also J. L. da Cruz Vilaça, The intensity of judicial review in complex economic matters—recent competition law judgments of the Court of Justice of the EU, *Journal of Antitrust Enforcement*, 2018, 6, p. 182, footnote 39.

44 See section III.C of Article 102 Guidance Paper, in particular para. 24.

45 Note that in C. Fumagalli and M. Motta, On the Use of Price-Cost Tests in Loyalty Discounts and Exclusive Dealing Arrangements: Which Implications from Economic Theory Should Be Drawn?, *Antitrust Law Journal*, Vol. 81, Issue 2, 2017, it is argued that an as efficient rival can generally only be excluded by conditional pricing if the price is below cost over a share of demand which is sufficient to deprive that rival from achieving the necessary economies of scale. This results from the assumption in the theoretical models they review that a rival/entrant can reach minimum efficient scale within one period, i.e., can overcome all scale disadvantages quickly. In practice, however, often it may not be possible for entrants/rivals to reach minimum efficient scale in a short period of time. Where economies of scale cannot be achieved quickly, the rival(s) may be foreclosed by pricing above cost.

46 See, for instance, F. M. Scott Morton and Z. Abrahamson, A Unifying Analytical Framework for Loyalty Rebates, *Antitrust Law Journal*, Vol. 81, No. 3, 2017, pp. 777–836.

Removing this disadvantage would restore the possibility of rivals to compete head-on with the dominant firm and thereby serve consumers. The rule would be that the price of the dominant firm should not be below its costs, with the latter, where relevant, being increased to reflect the estimated scale disadvantage imposed on its rivals. It is possible to make this estimate, at least in principle, because the disadvantage consists of an actual cost increase, imposed by the conduct of the dominant firm.⁴⁷ In the second scenario, the so-called “tax on rivals” is not an actual tax, not an actual cost increase, but a change in the opportunity costs: for the rival, the opportunity costs of competing are increased relative to the opportunity costs of retreating to a market niche. Intervention would not only create huge legal uncertainty (how much the dominant firm may influence the relative opportunity costs of its rivals), but would also risk undermining the essence of the competitive process itself.

47. The assessment of a change in the relative opportunity costs of competing versus retreating to a market niche (to fight or to flee) is an issue that extends beyond pricing conduct. In general, competition will hurt competitors. In the words of the ECJ in *Post Danmark* and *Intel*: “(...) competition on the merits may, by definition, lead to the departure from the market or the marginalisation of competitors that are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation.”⁴⁸ Competition takes place on a number of parameters, including pricing, branding, advertising, product differentiation and product development. On all these parameters, the conduct of firm A may often hurt the interests and/or change the incentives of firm B. But this does not mean that competition itself is harmed: on the contrary, this is the essence of competition. For instance, it is not difficult to find examples of product differentiation by a (dominant) firm which make life more difficult for competitors, such as creating products that are close to the rivals’ products in the product space. The same applies to all forms of pricing: it may easily affect the incentives of others to enter or expand on the market. Without a limiting principle for intervention—such as to restrict findings of abuse to cases where the strategy causes the dominant firm to incur avoidable losses which only make sense in view of the likely foreclosure effects—civil servants and courts would soon be required to assume that they know better than firms how to decide on competitive strategies. As in a centrally planned economy, it would then be for the (competition) authority to decide on what level of price, quality and variety is good for consumers. This is, of course, fundamentally at odds with the philosophy underlying the EU treaties.

48. That is why I began this section by saying that in cases where the theory of harm is that the conditional rebate scheme of the dominant firm is likely to have

⁴⁷ However, the practical difficulties of estimating the scale disadvantage and the resulting legal uncertainty for the dominant firm may lead some to argue that such cases should generally not be pursued.

⁴⁸ Para. 22 of *Post Danmark*; para. 134 of *Intel*.

an exclusionary effect by foreclosing competition, in principle it makes sense to apply the AEC principle and by extension the AEC test. The test is instrumental, in cases involving pricing conduct, to help us distinguish between interventions which are likely to protect competition and consumers and interventions which would merely protect less efficient competitors, while denying consumers the benefit of competition and lower prices driven by rebates. If fierce competition for marginal customers/contestable demand is avoided due to competition law applying form-based bans on certain types of rebate schemes, rivals which are equally or more efficient may also shelter longer under the price umbrella of the dominant firm than they would otherwise do, thereby delaying competition and the availability of lower rebated prices.⁴⁹

3. Which cost benchmark to apply?

49. So far, I have discussed the types of cases in which the AEC principle and the AEC test in theory will be useful when assessing dominant firms’ rebate schemes. I have explained why it does not make sense to apply the AEC principle and the AEC test in cases where the theory of harm concerns exploitation or collusion/dampening of competition. Conversely, in cases where the theory of harm is that the conditional rebate scheme of the dominant firm is likely to have an exclusionary effect by foreclosing competition, in principle it makes sense to apply the AEC principle and by extension the AEC test, while recognising that there are exceptions. This conclusion still leaves open the question of which cost benchmark to use when applying the AEC test. The answer to this question is, of course, important for the range of conditional pricing that may be found abusive.

50. The benchmark to be used should derive from the objective of applying the AEC test. The objective is to draw a line between pricing conduct that may be abusive because it may exclude as efficient competitors and conduct that will in principle not be abusive because companies that are equally efficient will, if challenged by the dominant company, be able to match such pricing and the resulting price competition will normally be characterised as competition on the merits.

51. For as efficient competitors to be able to compete in the longer term, it is necessary that the price should cover not only all variable costs, but also all fixed costs, including a competitive profit margin to attract sufficient capital. The benchmark to be used is therefore the ATC (average total cost) benchmark.⁵⁰

⁴⁹ See also H. Zenger, *Loyalty Rebates and the Competitive Process*, *Journal of Competition Law & Economics*, Vol. 8, No. 4, 2012, pp. 717–768.

⁵⁰ If the dominant firm is a multi-product undertaking, LRAIC (long-run average incremental cost) could be the benchmark. LRAIC is the average of all the (variable and fixed) costs that a company incurs to produce a particular product. LRAIC and ATC are good proxies for each other, and are the same in the case of single product undertakings. If multi-product undertakings have economies of scope, LRAIC would be below ATC for each individual product, as true common costs are not taken into account in LRAIC. Common costs are costs that cannot be avoided by not producing a particular product.

52. This benchmark allows a rebate scheme to be found abusive if the dominant firm prices effectively below ATC for its marginal/contestable sales. An abuse can thus be found even if the dominant firm is making a profit overall, by charging higher prices for its non-contestable sales. Competitors which are not an unavoidable trading partner for a (similar) share of demand in the market will not have (similar) non-contestable sales. They have to recover all their costs from demand which is contestable and will have to compete with the dominant firm's pricing for the contestable share of demand. With an effective price below ATC, these competitors, while being as efficient, could be forced to leave the market and consumers would then lose the benefits in terms of price and choice that they bring to the market.

4. Some remaining theoretical issues

53. While the ECJ stresses the relevance of the AEC principle and by extension the AEC test in both *Post Danmark* and *Intel*, it could also have chosen to apply the no-economic-sense test, by asking whether the conduct leads to avoidable losses or reductions in profit which only make commercial sense in view of the likely foreclosure effects. There are, however, two good reasons for not applying the no-economic-sense test. The first is the problematic nature of the test, which requires the authority or court to compare two hypothetical scenarios. Having to compare the profitability of the actual conduct as it would be without its foreclosure effects with the profitability of alternative conducts which the dominant firm could have chosen to adopt, makes it not the most practical alternative. The second reason relates to the policy aim of preventing consumer harm. The focus of the AEC principle and AEC test is correctly on the potential loss of consumer welfare by the foreclosure of efficient competitors, i.e., competitors that are able to compete head-on in terms of price and quality and challenge the position of the dominant firm. In cases where that type of robust consumer harm is shown, it should not be possible to absolve the dominant firm's conduct by showing that the conduct was the most profitable strategy even without the anti-competitive foreclosure effect. The prevention of consumer harm requires that the conduct be prohibited.⁵¹

54. Finally, it is worth pointing out that while in theory the retroactive rebate scheme of a dominant firm can have anti-competitive foreclosure effects on the main part of the market while at the same time dampening competition at the fringes of the market, in practice this is not a relevant scenario. Assume a dominant firm's retroactive rebate scheme forecloses its rival from the main part of the market and pushes it to a small part of the market or a market niche. Even though the rival is foreclosed from the main part of the market, this does not exclude that it could also use a retroactive rebate scheme to protect

its own small part of the market, thereby contributing to reducing the incentive of both dominant firm and rival to enter each other's part of the market and creating a competition-dampening effect on the fringes of the market. However, in practice, it would be difficult to use Article 102 against the competition-dampening effect, as the rival is unlikely to also hold a dominant position. This is different in the exceptional situation of collective dominance, in which case Article 102 could be used both to address a competition-dampening effect between the collectively dominant firms and to address anti-competitive foreclosure of other (potential) competitors.

V. Rebates and the AEC test: What are the practical problems?

55. So far, I have focused on the theory of when the AEC principle and the AEC test are useful for assessing dominant firms' rebate schemes. However, there is another area of discussion which concentrates on the practicability of applying an effects-based approach to rebates and, in particular, on the (alleged) practical problems of applying the AEC test. There is less debate nowadays about the need to apply an effects-based approach to unilateral conduct under Article 102, especially since the clear statements by the Court in that direction in *Post Danmark* and *Intel*. However, questions are raised about the practical difficulties of applying the AEC test to rebates. The question is in which situations these difficulties are important enough to prevent the use of the AEC test. This is the question I will seek to answer in the remainder of this article.

1. General practical arguments relating to the AEC test

56. The argument is made that price-cost tests are generally cumbersome and costly to apply, for instance because of difficulties in compiling good data, and are therefore not appropriate for regular use in competition cases. These arguments are not without merit and should encourage competition authorities and courts to use such tests sensibly, having regard to the circumstances in which they are used. For instance, if in a case likely anti-competitive foreclosure of as efficient competitors can be shown by using qualitative evidence only, this may be preferable in order to save scarce enforcement resources. It should also be clear that an authority should not be prevented from intervening by the refusal of a dominant firm to provide the necessary data in a timely manner. In that case too, the authority should be able to proceed on the basis of more qualitative evidence only.

⁵¹ That does not mean that a lack of intent to foreclose should play no role in the assessment. It could very well be an element relevant for the determination of the remedy and a possible fine.

57. However, these arguments do not call into question the general justification for using price-cost tests, which the Commission and the EU courts have already considered to be necessary to assess unconditional price cuts, predation and margin squeezes. Therefore, given that these arguments are not strong enough to dismiss the use of price-cost tests for the assessment of pricing conduct in general, the question is whether there are specific arguments why the AEC test should be discarded, for practical reasons, as a tool for the assessment of conditional pricing.

2. Practical arguments relating to the application of the AEC test to conditional rebates

58. The main argument used against the application of the AEC test to conditional rebates is that, for this type of pricing conduct, it is uncertain what is the contestable share or relevant range of demand over which the effect of the rebate needs to be calculated. According to this argument, this uncertainty makes it more difficult for the dominant firm to self-assess its pricing conduct and also increases the margin of error of the outcome of any AEC test applied by the competition authority. This argument first requires some explanation and then an analysis of whether and when it is valid.

59. In order to argue convincingly that conditional pricing is being used to foreclose anti-competitively, it must be shown, as a first step, that in the market in question competition does not take place for the customer and that, for whatever reason, the competitors of the dominant firm are not able to compete for the whole of customers' demand but only for part of their demand. The reason may be because customers are unwilling to switch away from the dominant firm completely, for instance because its product is a must-stock product. In short, the dominant firm must be an unavoidable trading partner. If that is not the case, conditional pricing, including exclusivity rebates, cannot exclude as efficient competitors, unless the overall price is predatory. The reason is simply that if competitors compete for the whole customer, the customer will compare the complete package offered by each competitor, including possible rebate schemes, on its attractiveness and overall price.

60. However, if the dominant firm is an unavoidable trading partner, a conditional rebate scheme may, in the words of the Article 102 Guidance Paper (para. 39), “enable it to use the ‘non-contestable’ portion of the demand of each customer (that is to say, the amount that would be purchased by the customer from the dominant undertaking in any event) as leverage to decrease the price to be paid for the ‘contestable’ portion of demand (that is to say, the amount for which the customer may prefer and be able to find substitutes).” How this works depends on whether it concerns an incremental or a retroactive rebate.

3. Practical arguments relating to the application of the AEC test to incremental rebates

61. In cases where an incremental rebate is used to foreclose, the dominant firm will generally try to set the threshold at the point where demand becomes contestable and will grant the rebate only on the sales above the threshold, i.e., where customers may want to switch.⁵² The effective price which the competitors have to match in order to be equally attractive is the rebated price charged by the dominant firm for the incremental units.

62. From the above analysis, it is immediately clear that there is no good reason not to apply the AEC test in cases involving incremental rebates.⁵³ In these cases, it is not necessary to determine the contestable share or relevant range and it is obvious what the effective price is: the price charged for the sales above the threshold where the rebate kicks in. In addition, for the application of the AEC test, it does not matter whether the incremental rebate scheme is standardised (the same for all customers) or individualised, or whether it has only one threshold or a number of steps with each step having its own rebated price.

4. Practical arguments relating to the application of the AEC test to retroactive rebates

63. Where a retroactive rebate is used to foreclose, the dominant firm will try to set the threshold at a level which includes the contestable share of demand (i.e., at the level of demand which it wants to obtain from the customer). The effective price which competitors have to match in order to be equally attractive is the price a (hypothetical) competitor producing the same product would have to offer in order to compensate the customer for the loss of the rebate if the latter switched part of its demand (this part being “the relevant range”) away from the dominant firm. Calculating the effective price requires multiplying the relevant range by the non-rebated price, deducting from that all the rebate lost in the event of switching and dividing the result by the relevant range, thereby arriving at the effective price per unit that competitors have to match.⁵⁴ It is this effective price which must be below the

52 If it set the threshold lower, it would mean granting a rebate for demand that anyhow will not switch at the higher price and this would lower its profit.

53 No good reason beyond what has already been explained in section V.I above as general practical arguments against using price-cost tests.

54 For instance, if a dominant firm charges a list price of €10 per unit of its product and offers a retroactive rebate of 10% once the purchases of a customer reach the threshold of 100 units, the average price is reduced to €9 once the customer purchases at least 100 units. If the customer buys anyhow 60 units from the dominant supplier at a price of €10, but is willing to switch supplier for additional units (in this case the remaining 40 units), the effective price a competitor with a product of the same quality will have to offer in order to match the loss of the rebate and be attractive for the customer to switch its demand of the remaining 40 units is €7.5 (40 x 10 (switched amount times list price) minus the lost rebate of 100x1 (100 units times the rebate of 1 per unit), divided by 40 (the amount that could actually be switched)).

cost of the dominant firm in order for the rebate scheme to be capable of foreclosing an as-efficient competitor.

64. The important question is thus whether establishing the relevant range in a retroactive rebate scheme is generally so problematic that the AEC test should be discarded as a tool for assessing retroactive rebates. To answer that question, it may be worth distinguishing between the difficulties faced by the dominant firm and the difficulties faced by the competition authority or court in ascertaining whether the pricing conduct is abusive.

65. As regards the first, it is important to recognise that a dominant firm applying a retroactive rebate scheme has every interest in assessing and estimating the relevant range, as it is important for its profitability to know what share of demand customers may want to switch and for which it therefore has to take competition into account. If it does not do so, it risks either giving more rebates than are necessary to keep its customers, or not enough rebates to keep its customers. In other words, it is part of firms' normal marketing efforts to analyse what share of demand is vulnerable to switching and how much of a rebate might prevent it from switching.

66. In addition, it is not uncommon in competition law to use concepts which require firms to assess customers' preferences and to evaluate the possibilities of rivals countering a strategy. For instance, market definition is based on the preferences of, and options available to, customers. But no-one would argue that firms—let alone dominant firms—are incapable of defining the relevant market. This is because identifying the relevant market is part of developing a proper marketing strategy. Similarly, it is accepted that in cases involving a refusal to supply, the dominant firm is expected to be able to analyse whether or not the input is indispensable for its competitors to operate on a downstream market, or, in cases involving tying, to be able to analyse whether or not its competitors can compete by offering a similar bundle.

67. The fact that the EU courts have stressed in a number of judgments that a dominant firm cannot be expected to know the costs of its competitors is not relevant, because applying the AEC test only requires the dominant firm to know its own costs. This answers the possible argument that dominant firms lack the capability to self-assess whether or not their retroactive rebate scheme could be abusive.

68. What about the difficulties faced by competition authorities and courts in assessing the relevant range and applying the AEC test to retroactive rebates? Here the same argument applies as above: it is important to recognise that similar difficulties do not seem to hinder authorities and courts from defining relevant markets or assessing the indispensability of an input, etc. In other words, there seems a priori no reason, in cases involving a retroactive rebate scheme, why the relevant range over which customers are willing and able to switch cannot be established, for instance, by surveying a representative group of customers or by analysing past switching

behaviour. However, it is important to observe that it may be more difficult to find and obtain relevant information and data, as they may be less readily and widely available than market definition evidence. This may in practice hinder the possibilities to usefully and timely apply a price-cost test to retroactive rebates. As further explained below, these possible problems are a matter of degree, which will also depend on the type of retroactive rebate.

5. Practical arguments relating to the application of the AEC test to standardised multi-step retroactive rebates

69. It may be reassuring to know that in cases involving retroactive rebate schemes with multiple steps/thresholds, defining the relevant range is generally no problem. Retroactive rebate schemes with multiple steps are usually “standardised”, i.e. the same for a group of customers. For these commonly used standardised retroactive rebate schemes, it can be expected that competition takes place (at least) over each step. In that case, each step is a relevant range and the calculation of the respective effective prices requires little work, as shown below.⁵⁵

Number of letters	Rebate %	Average price	Effective price
30,000 – 74,999	6	94	94.0
75,000 – 149,999	7	93	92.3
150,000 – 299,999	8	92	91.0
300,000 – 499,999	9	91	90.0
500,000 – 749,999	10	90	88.5
750,000 – 999,999	11	89	87.0
1,000,000 – 1,499,999	12	88	85.0
1,500,000 – 1,999,999	14	86	82.0
2,000,000 or more	16	84	78.0

70. The above table shows the rebate system at issue in *Post Danmark II*. In that case, the ECJ was asked which factors to take into account when assessing the standardised retroactive rebate scheme described in the first two columns of the table. The first column gives the thresholds in terms of number of letters handled by Post Danmark for a particular customer. It indicates the number of letters that the customer needed to send yearly in order to obtain a particular rebate. The second column states the retroactive rebate percentages that

⁵⁵ If the relevant range were smaller than one step, customers would be likely to stay within the step while switching part of their demand and there would be no need to calculate the relevant range, as no rebate step would be lost and no “leverage” would take place.

were granted by Post Danmark relative to a list price if the client reached the relevant thresholds. The third and fourth columns have been added by me. Adding these columns required little work; in fact, any undergraduate law student with a pocket calculator could do it in 15 minutes. The third column indicates the rebated price, as a percentage of the list price, that the customer pays to Post Danmark, and this for each step. It is 100 (the list price as 100%) minus the applicable retroactive rebate percentage from the second column. The last column is the effective price that the customer pays per step, which is the price that the competitor will have to offer to be equally attractive in terms of price if switching the full amount of the last step means that the customer loses one step of the rebate scheme. So, for instance, if the customer currently sends 150,000 letters and obtains a rebate of 8% and switches 75,000 letters (the amount of the previous step) to the competitor, it will go down one step and only obtain a 7% rebate on its remaining 75,000 letters with Post Danmark. In order to compensate the customer for this loss in rebate, the competitor would have to offer a price of no more than 91, compared to the average price of 92 that Post Danmark would receive if the customer did not switch.⁵⁶ The application of the AEC test for that step would thus entail determining whether a price of 91 was above or below Post Danmark's costs. For the table, as long as Post Danmark's costs were below 78% of the list price, the rebate scheme did not lead to pricing below cost for any of the steps involved.

6. Practical arguments regarding the application of the AEC test to individualised retroactive rebates

71. The remaining question is thus how difficult it is to assess the relevant range in case of, usually individualised, one-step retroactive rebate schemes. A first remark to be made here is that it may be instructive to look at the negotiations which led to the final agreement. These negotiations may indicate that in fact a number of thresholds with different rebate percentages were discussed, from which in the end one was chosen and agreed. This could indicate that at the time the customer was choosing between competing offers, the dominant firm was effectively offering a multi-threshold rebate. It could also indicate that if the threshold is not attained for whatever reason, including because the customer switches part of its demand, this could possibly lead to a renegotiation of a lower rebate, instead of the loss of the whole rebate. In other words, what may appear to be a single threshold rebate could in fact be a multi-threshold rebate, providing an indication of the relevant range, as explained in the previous subsection.

⁵⁶ The effective price of 91 results from $(150,000 \times 92) - (75,000 \times 93)$ divided by 75,000.

72. But in general, in case of individualised one-step retroactive rebate schemes, it will depend very much on the circumstances of the case how difficult it is to estimate the relevant range. Relevant information may be obtained from the dominant firm. As explained above, a dominant firm applying a retroactive rebate scheme has every interest in assessing and estimating the relevant range, as it is important for its profitability to know over what share of demand it has to take competition into account. The dominant firm may have done research and surveys to estimate to what extent its customers are willing and able to switch demand away under various (pricing) scenarios, and to which competitors such demand would most likely go.

73. For actual competitors, already present in the market, their actual size and sales to customers and fluctuations therein may provide an indication of the relevant range. In cases where competition from potential competitors is deemed important, it will be important to assess at what scale a new entrant would realistically be able to enter. If customers are likely to be willing and able to switch large amounts of demand to the new entrant relatively quickly, the relevant range is likely to be relatively large. If, on the other hand, customers are likely only to want to switch small amounts incrementally, then the relevant range will be relatively small. It may be possible to use the historical growth pattern of new entrants in the same or similar markets as an indication of a realistic market share for a new entrant.

74. In some cases, it will be a technical requirement that defines the relevant range. For instance, in the *Intel* case, it was obvious that competition took place over the chips required for new models of computers or laptops, as each model is designed around a particular central processing chip and demand for chips for the production of existing models (the “installed” base) can thus no longer switch. As a large share of the existing models was built around Intel chips and production of these models therefore required the PC manufacturers to purchase Intel chips, Intel could leverage the rebate granted for these chips to lower the effective price for the chips to be supplied for new models, for which the PC manufacturers were in the process of deciding which central processing chip to choose. This leveraging took place by making the rebates for the chips for the installed base (partly) dependent on the purchases of chips for the new models. The main difficulty in this case was therefore not what, in principle, the relevant range was—which was the demand for chips for these new contestable models—but to estimate how large the expected demand for these new models was or had been. This was a peculiarity of this case, which was overcome by the Commission analysing in depth the available documents expressing expectations about demand and, where available, draft contracts for specific numbers of chips.

75. Finally, in cases where it is not possible to estimate the relevant range, it may still be useful to calculate how big a share of customers' requirements the entrant would have to capture so that the effective price is at least as high as the average total cost of the dominant company.

Calculation of this “required share” can be done on the basis of the terms of the rebate scheme and costs of the dominant firm alone.⁵⁷ In a number of cases, the size of this share, when compared to the actual market shares of competitors and their shares of customers’ requirements, may make it clear whether the rebate system is capable of producing an anti-competitive foreclosure effect. Where the current individual rivals’ sales are smaller than the calculated required share, this indicates that the rebate scheme is likely to have a foreclosure effect on as efficient competitors. In that case, selling the required share to these customers would require these rivals, even if they were as efficient, to at least double their sales, in order to allow them to cover their costs while being able to match the customers’ loss of the dominant firm’s rebate. Doubling output and/or sales is not feasible in the short term in most industries. Conversely, in cases where the market share of each competitor is much bigger than the required share, the rebate system is unlikely to have a foreclosure effect that hinders competition. In the latter case, each as-efficient competitor would only have to increase its sales by a relatively small amount to be able to match the dominant firm’s rebate in a profitable way.

VI. Conclusion

76. In summary, to answer the question raised in the title of this article—whether conditional pricing and the AEC test form a happy couple—it is necessary to distinguish between the various theories of harm that may be applicable in a rebates case. In situations where rebates are used to dampen competition between incumbents or as an exploitative device, applying the AEC test does not make sense, and they would therefore make an odd couple. However, in cases where the theory is that rebates are being used as an exclusionary device, the AEC test makes a good partner. In these cases, applying the AEC test is in principle useful to help distinguish between abusive and non-abusive conduct.

77. This does not mean that where the theory of harm is about exclusion the marriage is always easy. In exclusionary abuse cases it still makes sense to take into account the possible practical difficulties of applying the AEC test. These difficulties depend partly on the type of rebate. It is obvious that in the case of an incremental rebate, where the rebate kicks in only for the units purchased beyond a certain quantity or share of a customer’s requirements, the effective price which the competitor has to match is not difficult to calculate: it is the lower price charged for the units purchased above the threshold. In that type of case, applying the AEC test is no different from applying it in a straightforward predation case involving a low uniform price. By contrast, in the case of one-step individualised retroactive rebates,

applying the AEC test may be more complex, and the results may be less reliable because they may be sensitive to assessments of the size of the contestable share of demand.

78. To conclude, in cases where the theory of harm is about exclusion, conditional pricing and the AEC test make a happy marriage. However, that does not mean that they are inseparable and that in every case of conditional pricing the AEC test will be a necessary partner. A competition authority should retain the discretion to decide which tools and methods are the most appropriate to show that a conduct is capable of/likely to foreclose as efficient competitors, based on the facts and circumstances of each case.

79. As for most tests, the reliability and relevance of the outcome of the AEC test depend very much on the quality of the data used. Where sufficiently reliable data is not available, conclusions may have to be drawn on the basis of qualitative evidence only. Where sufficiently reliable data is available, the level of precision of the data may still have to be taken into account when drawing conclusions from the AEC test.⁵⁸

80. The AEC test could thus help to create a safe harbour for pricing above average total cost. This safe harbour may not be absolute, because even if the price of the dominant firm remains above its costs, consumer harm cannot be excluded, in particular if the pricing conduct is able to prevent competitors from achieving economies of scale. However, it would be good practice, in cases where the effective price remains above average total cost, to justify any intervention with arguments and facts showing how the conduct of the dominant firm is increasing the costs of its rivals or is otherwise impeding their efficiency or innovativeness, thereby hindering them from becoming as efficient.

81. Finally, the use of the AEC test should always be embedded in a wider effects-based approach. Competition and, as a result, consumer welfare is not automatically harmed by pricing below cost, while at the same time harm cannot be excluded if the price remains above cost. A price-cost test is one part of the effects-based assessment, which should also take into account the share of the market affected by the conduct, the strength of the firm’s dominant position, the options for competitors and customers to counter the conduct, etc., in order to tell a cogent and convincing story about how the allegedly abusive conduct is likely to lead to anti-competitive foreclosure. The need for this broad effects analysis, already proposed by the Article 102 Guidance Paper, was emphasised by the ECJ in paragraph 139 of the *Intel* judgment.⁵⁹ ■

⁵⁸ Similar caveats are expressed in para. 25, 27, 41 and 42 of the Article 102 Guidance Paper.

⁵⁹ See also J. L. da Cruz Vilaça, The intensity of judicial review in complex economic matters—recent competition law judgments of the Court of Justice of the EU, *Journal of Antitrust Enforcement*, 2018, 6, p. 186:“(…) the ECJ also made it clear that the balancing of favourable and unfavourable effects on competition of the practice in question can be carried out only after the analysis has shown the intrinsic capacity of that practice to foreclose competitors that are at least as efficient as the dominant undertaking.”

⁵⁷ For more details, see DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005, points 155–156, found at: <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf>. The required share is defined as the share of customers’ requirements that the entrant would need to capture so that the effective price is at least as high as the average total cost of the dominant company.

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