THE ANTITRUST ASSESSMENT OF LOYALTY DISCOUNTS AND REBATES: TOWARDS A STRUCTURED RULE OF REASON

GIANLUCA FAELLA

1. Introduction

Loyalty discounts and rebates (“loyalty discounts”) include several different schemes of incentives granted by a supplier to customers, distributors or agents provided that their purchases or sales of the relevant products achieve or exceed certain thresholds formulated in terms of a percentage of total requirements (fidelity discounts and rebates),\(^1\) or an individualized volume target (target discounts and rebates).\(^2\) Loyalty discounts lie at the heart of the debate on the treatment of single firm conduct, probably the most controversial issue in contemporary antitrust practice both in the EU and US antitrust systems. In the application of Article 82 EC the Commission developed a *sui generis* policy. The influence of the ordo-liberal school of Freiburg led to much emphasis being placed on the necessity to protect the freedom of action of minor competitors and customers from the economic power of major firms. Some types

---

\(^{1}\) Fidelity discounts may be conditioned on the achievement of certain thresholds, or granted in exchange for an explicit exclusivity obligation, thus giving rise to a form of exclusive dealing.

\(^{2}\) As a general rule, the target is set on the basis of the client’s requirements, so as to correspond to all or a large part of his demand. Accordingly, fidelity and target discounts and rebates tend to have similar effects, as recognized by the Commission’s decision practice: see Commission decision of March 20, 2001, Case COMP/35.141, *Deutsche Post AG*, O.J. L 125/27 (2001); and July 14, 1999, Case IV/D-2/34.780, *Virgin/British Airways*, O.J. L 30/1 (2000). The choice between the two types of practices may depend on the stability and predictability of demand. When demand fluctuates significantly over time or cannot be easily observed, suppliers may prefer to make reference to a certain percentage of the customers’ requirements, rather than predetermined individual targets. Both the fidelity and target discount systems may provide for a single threshold or a grid of ascending thresholds, corresponding to increasing discount rates.
of conduct have been considered exclusionary in light of their tendency or abstract capability to prejudice rivals, without carrying out a detailed analysis of their actual or potential impact on competition and (total or) consumer welfare. The concept of special responsibility of dominant undertakings developed by the European Court of Justice (ECJ) translated into a case-by-case and form-based approach, lacking an underlying theoretical framework and solid economic roots.

In the last few years, it began to be widely understood that a vague and ambiguous notion of abuse, without limiting principles based on a coherent theoretical framework, is likely to result in many false positives and seriously anticompetitive decisions. In December 2005, the Commission issued a discussion paper on abuse of dominance (the “Discussion Paper”). 3 This document represents an ambitious and, under many respects, appreciable attempt to clarify and rationalize the implementation of Article 82 EC. However, the lack of a clear and widely accepted theoretical framework for the assessment of unilateral conduct, together with the need to act within the framework of ECJ’s past case law, seems to curb the transition towards a more economic-based enforcement policy. Given their intrinsic ambivalent nature, discount and rebate policies represent a kind of laboratory, where it is possible to test both the economic soundness of the current Article 82 enforcement and the innovations that might be introduced in order to define a more reliable and coherent abuse standard.

This paper is structured as follows: section 2 addresses the economic analysis of loyalty discounts, taking into account the potential exclusionary effect, further anticompetitive effects and possible business justifications; in section 3, the traditional approach of the Community institutions and its main drawbacks and inconsistencies are analyzed; section 4 sketches the main innovations proposed by the Discussion Paper; section 5 compares the approach suggested by the Discussion Paper with the subsequent Tomra decision and British Airways judgment; section 6 proposes a structured rule of reason for the assessment of loyalty discounts; finally, section 7 draws some general conclusions based on the analysis carried out in the previous sections.

2. The economic analysis of fidelity and target discounts and rebates

Loyalty discounts lie close to the thin line between anticompetitive conduct and legitimate competition: on the one hand, the practice may have exclusionary effects or otherwise injure consumers by softening interbrand competition; on the other hand, loyalty discounts constitute an effective competitive tool and may solve coordination problems in the production chain, thus giving rise to efficiency gains.

2.1. The exclusionary effect

Loyalty discounts represent a classical form of nonlinear pricing. 4 When applied retroactively to the entire amount of purchases realized by a customer during a

---

3 See DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005, available on the Commission’s website. Interestingly, the most significant changes to the current approach would concern the treatment of discounts and rebates, where the state of the law is commonly perceived as more unsatisfactory.

4 Nonlinear pricing arises when the price paid by a customer is not strictly proportional to the quantity purchased. See R. WILSON, Nonlinear Pricing, Oxford, 1992.
certain reference period, loyalty discounts may determine a kind of lock-in effect, in that they generate switching costs for buyers.² If customers decided to differentiate their supply sources and failed to achieve the thresholds set by the dominant firm, they would lose discounts or rebates calculated retroactively on the products they have already purchased during the reference period, as well as on additional units they would buy in any case from the supplier.

Loyalty discount schemes produce a so-called suction effect. When customers are close to the threshold, a small increase in purchases would trigger the discount or rebate for all the units purchased from the dominant firm in the reference period. As a consequence, the incremental price of the units necessary to achieve the threshold may be substantially lower than both the list price and the discounted price. The incremental price \( p(x^*) \) is expressed by the following formula:

\[
p(x^*) = p (x^* - \alpha x^T)/x^*
\]

where \( p \) is the list price, \( x^* \) is the amount of purchases necessary to achieve the threshold \( x^T \) and \( \alpha \) is the discount rate. As shown by formula [1], the higher the discount rate, the threshold and the purchases already made during the reference period, the lower the incremental price. Due to the retroactive character of the system, the incremental price of the units necessary to achieve the threshold may be below cost or even negative, although the final price is not predatory.³

However, the fact that the incremental price of units necessary to achieve the threshold is lower than cost does not necessarily imply that equally efficient firms cannot compete. First, if the threshold is lower than customer’s total requirements, competitors may be able to distribute the discount over a larger amount, including the additional units of the client’s demand. Secondly, assuming that firms compete for the entire demand of the customer, at the beginning of the reference period there are no costs for switching, so that an equally efficient rival should be able to match the offer of the dominant firm, provided that the final price is not predatory. Switching costs tend to rise as the time goes on, but generally remain relatively low in the initial part of the reference period. Thus, loyalty discounts would simply change the nature of competition. The latter would cease to be a continuous process to secure customers’ marginal purchases and would turn into a periodic contest to supply the whole or a large part of their requirements.⁴

---


³ Consider for instance a rollback rebate system under which a supplier offers a 5 percent rebate on a unit price of 10 if the quantity purchased is equal to 100 units or greater. When the units purchased increase from 99 to 100 and the threshold is reached, total expenditure falls from 990 to 950, meaning that the incremental price of the last unit is negative. For a discussion and a graphic representation of marginal and average prices and total expenditure under a retroactive discount system, see G. FEDERICO, When are Rebates Exclusionary, in European Competition Law Review, 2005, 477.

For a discount system to have serious exclusionary effects, it is necessary that the dominant undertaking holds a substantial market power over a significant part of the customer’s demand (the so-called assured base of sales), so that rivals cannot compete for the entire requirements of individual buyers. If a significant share of a customer’s demand is monopolized, an equally or more efficient competitor may not be able to compete for the contestable portion of the customer’s requirements. In order to compensate the customer for the loss of the retroactive discount on purchases from the dominant firm, the competitor would have to grant a very high discount on a low amount of sales. The dominant undertaking could grant discounts on the inelastic portion of individual customers’ demand in order to increase its sales or protect its market share from competition.\(^\text{10}\)

A useful indicator of the practice’s foreclosure effect is the incremental price of the contestable portion of the customer’s demand. This price may be expressed by the following formula:

\[
p(x^C) = p \left[ x^C - \alpha (x^M + x^C) \right]/x^C \tag{2}
\]

where \(p\) is the list price, \(\alpha\) is the discount rate, \(x^M\) is the assured base of sales and \(x^C\) is the contestable portion of the customer’s demand. As shown by formula [2], the incremental price of the contestable portion of the customer’s demand decreases as the discount rate and the assured base of sales increase. If the incremental price of the contestable units of the customer’s demand is lower than an appropriate cost benchmark, the discount system may prevent efficient firms from competing for the contestable share of the client’s demand. In the opposite case, an equally or more efficient competitor would be able to match the offer of the dominant firm.

However, even when the incremental price of the contestable units is not predatory, the practice may be used strategically to limit the competitive capacity of competitors. Rivals might not be interested in competing for the entire contestable portion of demand, if they can earn higher profits by selling only the units above the threshold at a higher price, instead of attempting to compensate customers for the loss of discounts granted by the dominant undertaking. If the contestable portion of clients’ demand below the threshold is not large enough, competitors might be better off by simply forsaking the sale of such units, although they are theoretically open to competition.

2.2. *Further anticompetitive effects of loyalty discounts: lessening of interbrand competition and increase in the level of initial prices*

Besides causing potential foreclosure of competitors, a loyalty discount scheme may have further anticompetitive effects. First, given that purchasers do not know for certain whether they will benefit from the discount until the end of the reference period,

\(^9\) The existence of an assured base of sales may be due to several factors, such as brand loyalty, product differentiation, switching costs or capacity constraints faced by competitors: see A. MAJUMDAR-S. BISHOP-D. Ridyard-I. Williams-U. Akgun, *Selective Price Cuts And Fidelity Rebates*, Economic Discussion paper prepared by RBB for the Office of Fair Trading, July 2005, 117 ff.

the practice may generate uncertainty about the level of final prices, thus hampering the comparison between competing offers and weakening interbrand competition. Secondly, by creating incentives for total or partial exclusivity in relationships with distributors, the practice may reduce in-store interbrand competition and, as a consequence, the elasticity of demand perceived by producers, thus favoring an increase in the price level.\textsuperscript{11} Similarly, switching costs created by a loyalty discount system contribute to reducing the elasticity of customers’ demand and, therefore, may lead to higher equilibrium prices, to the detriment of consumer interests.\textsuperscript{12} Finally, the grant of discounts may be accompanied by an increase of the initial price (so called penalty prices). In such a situation, the system would give rise to ambiguous effects on allocative efficiency and consumer welfare, as it would penalize buyers unable to achieve the thresholds, without necessarily benefitting customers that meet the threshold.\textsuperscript{13}

However, in all the above-mentioned cases, it may be difficult to control and prevent the anticompetitive use of loyalty discounts through antitrust law instruments, at least by applying rules on unilateral conduct. The use of loyalty discounts as a tool to soften interbrand competition might be considered as a collusion facilitating device in an investigation based on Article 81 EC, but it is unlikely to constitute an abuse of dominance under Article 82 EC.\textsuperscript{14}

2.3. Efficiency gains and business justifications

Even if loyalty discounts do not exactly reflect cost savings made possible by single orders, the practice may be justified by legitimate business reasons and, in many cases, may benefit not only producers but also consumers.\textsuperscript{15} First, loyalty discounts determine a reduction in the price level, which may break collusive equilibriums and benefit consumers,\textsuperscript{16} unless the grant of discounts is accompanied by an increase of initial prices. Secondly, in markets with very high fixed costs, loyalty discounts contribute to reducing per unit costs by increasing total sales, and allow the implementation of forms of Ramsey pricing, which may lead to a more efficient allocation of resources.\textsuperscript{17} Thirdly, the practice can be used to implement a form of

\begin{itemize}
\item \textsuperscript{13} See P. GREENLEE-D.REITMAN, Competing with Loyalty Discounts, U.S. Department of Justice EAG Discussion Paper 04-2, 2005.
\item \textsuperscript{14} A possible exception might theoretically be the unusual case in which a group of collectively dominant undertakings used the practice to limit, to a certain extent, their reciprocal competitive pressure.
\item \textsuperscript{16} In oligopolistic markets, firms may have low incentives to implement a linear reduction of prices, since such reduction would be more transparent and might be readily replicated by rivals: see J. KALLAUGHER-B. SHER, Rebates Revisited: Anti-Competitive Effects and Exclusionary Abuse Under Article 82, in European Competition Law Review, 2004, 263.
\item \textsuperscript{17} The practice allows for the sale of additional units to customers who value the product more than its price and contributes to covering the fixed costs, thus increasing the incentives of firms to invest and
\end{itemize}
second-degree price discrimination, which may increase sales and generate efficiencies.\(^{18}\)

In addition, the practice may allow undertakings to improve the coordination in the production chain by solving principal-agent problems, similarly to exclusive dealing clauses.\(^{19}\) In particular, loyalty discounts may stimulate dealers’ sale efforts and promotional services, by increasing the level of profits earned by distributors on marginal sales.\(^{20}\) Furthermore, when a company has to realize relationship-specific investments to satisfy the needs of a particular customer, a loyalty discount system may represent a tool – less restrictive than an exclusive dealing clause – to guarantee the recovery of investments made by the producer.\(^{21}\) Similarly, if a producer has made significant investments to improve the competitive capacity of distributors (for instance through financing, the transfer of know-how or training), loyalty discounts may prevent free-riding by competing suppliers, that might utilize the same distribution channels in order to take advantage of the dominant undertaking’s efforts.\(^{22}\)

Finally, it should also be noted that, instead of being driven by the dominant company’s intention to strengthen or preserve its market power, the use of loyalty discounts might be a response to the buying power of purchasers. The latter may be

---

\(^{18}\) In particular, when it is difficult to identify customers with an elastic demand, a discount system may function as a tool to induce self-selection by buyers. See A. PERA-V.auricchio, Consumer Welfare, Standard of Proof and the Objectives of Competition Policy, in European Competition Journal, 2005, 153. S. Kolay-G. Shaffer-J. Ordover, All-unit Discounts in Retail Contracts, in Journal of Economics & Management Strategy, 2004, 429, show that retroactive discounts can be a welfare improving mechanism to price discriminate between retailers.


\(^{20}\) Loyalty discounts make the average price offered to distributors higher than the marginal price. Since the latter determines the distributors’ incentive to undertake promotional and sale efforts to sell additional units of the products concerned, the practice may be a strategic tool to boost sales. See D. Spector, supra note __; D.E. Mills, Market Share Discounts, May 12, 2004, available on the website www.virginia.edu, and OECD, supra note __. Even though some promotional activities may be contracted upon, an incentive system may be a more effective and less intrusive instrument to secure the sale efforts of a distributor, if the latter is in a better position to establish which initiatives should be adopted or if it is difficult to monitor the fulfillment of contractual obligations. See D.E. Mills, supra; J. Kallaugher-B. Sher, supra note __; and A. Majumdar-S. Bishop-D. Ridyard-I. Williams-U. Akgun, supra note __. See also S. Kolay-G. Shaffer-J. Ordover, supra note __, according to whom retroactive discounts can be a means of eliminating vertical price inefficiencies caused by double marginalization.


willing to commit themselves to purchase the whole or a large part of their requirements from the same producer in exchange for better conditions.

3. Loyalty discounts and competition law

Faced with a form of price competition that may be exclusionary, but whose effects are extremely difficult to ascertain, the EU and US authorities have adopted opposite approaches. In the United States, the fear to lessen price competition, together with the idea that “rewarding customer loyalty promotes competition on the merits”, has led to a very strong presumption of legality of discounts and rebates, provided that they are not predatory, or bundled. The presumption of legality seems to be rebuttable only by showing tangible exclusionary effects to the detriment of consumers, although some courts seem ready to adopt a more cautious stance.

23 See A. MAJUMDAR-S. BISHOP-D. RIDYARD-I. WILLIAMS-U. AKGUN, supra note __.

24 Virgin Atlantic Airways Ltd. v. British Airways PLC, 257 F.3d 256, 265 (3rd Cir. 2001).

25 In Barry Wright, the Court noted that “the Sherman Act does not make unlawful prices that exceed both incremental and average costs”, on the assumption that prohibiting above cost pricing “threatens to ‘chill’ highly desirable pro-competitive price cutting”: see Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 235-236 (7th Cir. 1979). Similarly, in Henry v. Chloride, Inc., the Court underlined that “nonpredatory price cuts are to be encouraged under antitrust law”, adding that “at some point, competitors should know for certain they are pricing legally, and … this point should be average total cost. In other words, prices above average total cost are legal per se”: see Henry v. Chloride, Inc., 809 F.2d 1334, 1344, 1346 (8th Cir. 1987). In Brooke Group, the Supreme Court explained that, in case of above-cost discounting, it “is beyond the practical ability of a judicial tribunal to control without courting intolerable risks of chilling legitimate price cutting”: see Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

26 The controversial and widely debated judgment delivered by the Court of Appeal for the Third Circuit in Le Page’s stated that bundled discounts (i.e., discounts conditioned on the achievement of certain thresholds in the purchase of different products) may exclude competitors, if the latter do not provide an equally diverse group of services: see Le Page’s v. 3M, 324 F.3d 141 (3rd Cir. 2003). However, the Court of Appeal for the Ninth Circuit recently underlined the necessity to apply a price-cost test to determine whether, as a result of the bundled discount system, the product open to competition is sold at a below cost incremental price: see Cascade Health Solutions v. PeaceHealth, CV-02-06032 (Sept. 4, 2007).

27 In Concord Boat Corp. v. Brunswick Corp., the Court noted that price cuts represent “the very essence of competition”, so that, if the discounted price is above average variable cost, “the plaintiff must overcome a strong presumption of legality by showing other factors indicating that the price charged is anticompetitive”: Concord Boat Corp. v. Brunswick Corp., 207 F. 3d 1039, 1061 (8th Cir. 2000); see also Morgan v. Ponder, 892 F.2d 1355, 1360 (8th Cir. 1989). In Virgin Atlantic Airways Ltd. v. British Airways PLC, a bonus system similar to that condemned by the Commission in the European British Airways case was considered lawful because the plaintiff had not proved that the practice was predatory or had anticompetitive effects: see Virgin Atlantic Airways Ltd. v. British Airways PLC, 257 F.3d 256 (3rd Cir. 2001). On May 10, 2007, in JBDL Corp v Wyeth-Ayerst Laboratories Inc., the Sixth Circuit affirmed the dismissal of a class action and individual complaints challenging the loyalty rebate programme implemented by a dominant company, on the ground that there was no evidence of a causal link between the contested conduct and price increases in the market concerned. See also Stitt Spark Plug Co. v. Champion Spark Plug Co., 840 F.2d 1253 (5th Cir. 1988); R.J. Reynolds Tobacco Co. v. Philip Morris, Inc., ---F.3d--- (3rd Cir. 2003) (en banc).

28 In Minnesota Mining, the District Court noted that the inelastic base of customers’ demand could be used to make it more difficult for rivals to buy from other suppliers. Accordingly, it denied a summary judgment motion: see Minnesota Mining & Mfg. Co. v. Appleton Papers Inc., 35 F. Supp. 2d 1138, 1144 (D. Minn. 1999). A summary judgment motion was denied also in Avery Dennison Corp. v. ACCO Brands, Inc., 2001–1 Trade Cas. (CCH) ¶72,882 (C.D. Cal. 2000), and In re Hypodermic Products Antitrust Litigation, No. 05-CV-1602 (JLL/CCC) (D. N.J. June 29, 2007).
Similarly, some leading antitrust scholars have expressed the view that, as a classical form of price competition, loyalty discounts should be presumed lawful, provided that the final price is not predatory.\footnote{In particular, it has been stated that “as long as prices are above the relevant measure of cost the discounts cannot exclude an equally efficient rival”, since “the penalty for not taking the specified percentage is not a breach of contract suit or termination of a franchise. Rather, it is simply the loss of the discount. But the loss of the discount is not a penalty at all if a rival is willing to match the discounted price”: H. HOVENKAMP, Discounts and Exclusions, The University of Iowa Legal Studies Research Paper, n. 05-18, August 2005, available on the internet at www.ssrn.com. See also T.A. LAMBERT, Evaluating Bundled Discounts, in Minnesota Law Review, 2005, 1688; P. AREEDA-H. HOVENKAMP, Antitrust Law, 2002, 768b2, 149; H. HOVENKAMP, Antitrust Law, 1998, 1807c, n. 16. However, other commentators seem to be much more skeptical about the competitive impact of so-called “market-share discounts”: see W. TOM-D. BALTO-N. AVERITT, Anticompetitive Aspects of Market-Share Discounts and Other Incentives to Exclusive Dealing, in Antitrust Law Journal, 2000, 615, according to whom the practice should be analyzed in light of principles on exclusive dealing.}

In the EU, the tendency to induce loyalty, if not a mere intent to exclude rivals, is deemed sufficient to justify the prohibition of the practice, on the ground that the special responsibility of dominant undertakings requires them not to make it more difficult for rivals to access the market. In particular, the Commission and EC courts have maintained that the grant of loyalty discounts by dominant firms is incompatible with Article 82 EC on the basis of four main grounds: (i) the loyalty-inducing effect, which may hinder competitors’ access or expansion (primary line injury); (ii) the discriminatory character (secondary-line injury); (iii) the unfairness; and (iv) the tendency to compartmentalize the common market. In addition, the Community institutions have constantly held that loyalty discounts are not objectively justified, since they do not exactly reflect cost savings made possible by large orders.

3.1. The loyalty inducing effect

According to established case law and decision practice, fidelity and target discounts offered by dominant undertakings are incompatible with Article 82 EC, because they tend to remove or restrict the buyer’s freedom to choose his sources of supply, thus hindering competitors’ access to the market or expansion.\footnote{Fidelity discounts by dominant firms have been considered illegal almost per se, not only when they are granted in exchange for an explicit exclusivity obligation, but also when they are merely conditioned on the achievement of certain thresholds. See, in particular, Commission decision of January 2, 1973, Case IV/26.918, European sugar industry, O.J. L 140/17 (1973); Court of Justice, December 16, 1975, Joined Cases 40-48, 50, 54-56, 111, 113 and 114/73, Coopertivie Vereniging Suiker Unie U.A. and others/Commission, in ECR, 1975, 1663; Commission decision of June 9, 1976, Case IV/29.020, Vitamins, O.J. L 223/27 (1976); Court of Justice, February 13, 1979, Case 85/76, Hoffmann-La Roche/Commission, in ECR, 1979, 965; Commission decision of December 5, 1988, Case IV/31.900, BPB Industries plc, O.J. L 10/50 (1989); Court of First Instance, April 1, 1993, Case T-65/89, BPB Industries plc v British Gypsum Ltd/Commission, in ECR, 1993, II-00389; Commission decision of December 19, 1990, Case IV/33.133-C, Soda ash - Solvay, O.J. L 152/21 (1991), and December 19, 1990, Case IV/33.133-D, Soda ash - ICI, O.J. L 152/40 (1991); Commission decision of March 20, 2001, Case COMP/35.141, Deutsche Post AG, O.J. L 125/27 (2001); Decision Commission of June 20, 2001, Case COMP/E-2/36.041/PO, Michelin, O.J. L 143/1 (2002); and Court of First Instance of September 30, 2003, Case T-203/01, Manufacture française des pneumatiques Michelin/Commission, in ECR, 2003, II-04071. Target discounts have been subject to similar treatment: see Commission decision of October 7, 1981, Case IV/29.491, Bandengroothandel Frieschebrug BV/NV Nederlandsche Banden-Industrie Michelin, O.J. L 353/33 (1981); Court of Justice, November 9, 1983, Case 322/81, NV Nederlandsche Banden-Industrie Michelin/Commission, in ECR, 1983, 3461; Commission decision of May 14, 1997, Case T-106/94, SNCF/Commission, in Case T-106/94, SNCF/Commission, in ECR, 1996, I-10741.} The reason is...
that loyalty discounts exert a pressure on customers to purchase from the dominant undertaking, in particular towards the end of the reference period, since the achievement of the thresholds allows buyers to benefit from a discount, or a higher discount rate, on the entire turnover realized during such period. Based on the vague concept of special responsibility, the Commission and the European Courts have traditionally held that, for a discount system to be abusive, a tendency to exclude or hinder competitors, by making it more difficult for them to access the market or increase their sales, is sufficient. In some cases, the mere intention to harm competitors or discourage their entry into the market seemed to justify the prohibition of the practice.

The Community institutions have repeatedly held that, as the duration of the reference period and the time already elapsed increase, the pressure on buyers becomes more intense. However, it is difficult to determine the critical duration of the reference period. The indications offered by EC case law and decision practice are ambiguous and, to a certain extent, contradictory. In any case, a significant duration

---


32 See, inter alia, Court of First Instance, September 30, 2003, Case T-203/01, Manufacture française des pneumatiques Michelin/Commission, in ECR, 2003, II-04071, § 239, where the CFI stated that, to establish an abuse under Article 82 EC, 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”. See also Court of First Instance, December 17, 2003, Case T-219/99, British Airways plc/Commission, in ECR, 2003, II-5917, § 250; and October 7, 1999, Case T-228/97, Irish Sugar/Commission, in ECR, 1999, II-2969, § 114.

33 In some cases, the Court of First Instance stated the equivalence of the anticompetitive object and effect for the purposes of assessing discount systems (see, in particular, Court of First Instance, September 30, 2003, Case T-203/01, Manufacture française des pneumatiques Michelin/Commission in ECR, 2003, II-04071; October 7, 1999, Case T-228/97, Irish Sugar/Commission, in ECR, 1999, II-2969, § 170; and April 1, 1993, Case T-65/89, BPB Industries plc and British Gypsum Ltd/Commission, in ECR, 1993, II-00389), notwithstanding that, under Article 81, only very serious restraints are unlawful for their object, whereas the competitive impact of loyalty discounts is at least ambiguous.


35 In Court of Justice, November 9, 1983, Case 322/81, NV Nederlandsche Banden-Industrie Michelin/Commission, in ECR, 1983, 3461, the ECJ seemed to suggest that only a relatively long reference period — in that case, one year — may trigger the fidelity-enhancing effect of a dominant firm’s discount scheme. In San Pellegrino, the Commission decided not to act against a discount system in the market for colas, subject to the condition that the reference period did not exceed three months. In the
of the reference period is considered a factor able to strengthen the fidelity-inducing effect of a rollback discount system, but it does not constitute a \textit{condicio sine qua non} for prohibiting the practice.

A strong inequality between the dominant firm’s and competitors’ market shares is also considered a factor able to strengthen the fidelity-enhancing effect of a rollback discount system. According to the Commission and EC courts, in order to compensate a customer for the loss of the financial advantages granted by the dominant firm, a minor rival willing to increase its sales by a small amount should offer a remarkably higher discount rate on significantly lower volumes.\textsuperscript{36}

In the assessment of the practice, the Community institutions have also taken into account the exiguity of margins collected by distributors, on the assumption that, if dealers’ mark-ups are very low, obtaining the discounts may be indispensable to avoid losses and earn some profits.\textsuperscript{37} Similarly, according to the \textit{communis opinio}, the state of uncertainty caused by a lack of transparency in the application of the system and its discretionary character may discourage the differentiation of supply sources, thus increasing the pressure on the buyer to achieve the thresholds and hindering the comparison between prices charged by different suppliers.\textsuperscript{38}

The traditional approach of the Community institutions is not convincing under many respects. The condemnation of fidelity and target discounts in EC competition law is not founded on a careful assessment of the possibility to match the dominant firm’s offer. In many cases, the Commission and EC courts underlined that discounts calculated on the basis of total purchases are particularly harmful for minor


\textsuperscript{37} See Commission decision of June 20, 2001, Case COMP/E-2/36.041/PO, \textit{Michelin}, O.J. L 143/1 (2002), the Commission criticized the significant duration of the reference period, equal to one year, because it increased the pressure to purchase exclusively from the dominant company towards the end of the period. To the contrary, the analysis of the practice seems to be unaffected by the duration of the reference period in the Commission decisions of May 14, 1997, Case IV/34.621, 35.059/F-3, \textit{Irish Sugar plc}, O.J. L 258/1 (1997) (where the Commission stated that discounts based on single order are lawful, unlike those calculated on the basis of weekly, monthly or yearly individual targets) and July 14, 1999, Case IV/D-2/34.780, \textit{Virgin/British Airways}, O.J. L 30/1 (2000) (where the Commission remained silent on the question of the duration of the reference period, which varied from one month to one year). However, it has been noted that the incongruities arisen in the antitrust practice are not necessarily negative, since they may reflect, to a certain extent, the peculiarities of different sectors: see B. SHER, \textit{Price Discounts and Michelin 2: What Goes Around, Comes Around}, in \textit{European Competition Law Review}, 2002, 482.

competitors, which commercialize smaller amounts and, therefore, are obliged to offer much lower prices if they want to remain competitive compared to the dominant firm.\footnote{See, inter alia, Commission decision of December 19, 1990, Case IV/33.133-C, Soda ash - Solvay, O.J. L 152/21 (1991), §§ 16-18.} In some cases, the Commission estimated the price that a rival had to offer in order to win a certain share of a customer’s requirements from the dominant undertaking, and demonstrated that this price was not remunerative for competitors.\footnote{See Commission decision of January 2, 1973, Case IV/26.918, European sugar industry, O.J. L 140/17 (1973); and July 14, 1999, Case IV/D-2/34.780, Virgin/British Airways, O.J. L 30/1 (2000); in the Italian antitrust practice, see decision of the Italian Competition Authority of June 27, 2001, No. 9693 (A291), Assoviaggi/Alitalia, in Bollettino No. 26/2001.} However, a detailed assessment of the possibility for competitors to match the dominant undertaking’s offer is not an integral part of the evaluation standard traditionally applied by the Commission. The general principle underlying EC case law and decision practice is that a dominant undertaking can grant price reductions reflecting efficiencies, but it is not allowed to offer discounts or incentives encouraging the fidelity of customers,\footnote{The Commission’s approach has been fiercely criticized by legal commentators and antitrust scholars. See, inter alia, J. Temple Lang, Abuse under Article 82 EC: Fundamental Issues and Standard Cases, St. Gallen Conference 2006, April 19, 2006, according to whom the fidelity inducing test developed by the Commission “is hopelessly ambiguous” and “provides no way of distinguishing between legitimate and unlawful competition”.} regardless of whether competitors are able to match the dominant firm’s commercial policy.

Similarly, the assessment of the extent of foreclosure in comparison with the minimum efficient scale to be active in the relevant sector, as well as the analysis of the impact of the practice on the degree of competition and consumer welfare, do not seem to constitute prerequisites for antitrust intervention. In some cases, the Community institutions presumed the existence of an exclusionary effect, notwithstanding that the dominant company’s market share and price level had decreased and the rivals’ sales had increased.\footnote{See, in particular, Court of First Instance, December 17, 2003, Case T-219/99, British Airways plc/Commission, in ECR, 2003, II-5917, §§ 293-298; and Court of First Instance, September 30, 2003, Case T-203/01, Manufacture française des pneumatiques Michelin/Commission, in ECR, 2003, II-04071, §§ 239-245.} Although in some cases the Commission’s analysis is more accurate,\footnote{See, for instance, Commission decision of March 20, 2001, Case COMP/35.141, Deutsche Post AG, O.J. L 125/27 (2001).} the Community institutions have not hesitated to prohibit any forms of incentives to (partial) exclusive dealing, even in the presence of evidence – such as an increase in competitors’ market shares and the reduction of the price level – raising serious doubts on the foreclosure effect of the system and its negative impact on consumer interests.\footnote{See, in particular, Court of First Instance, September 30, 2003, Case T-203/01, Manufacture française des pneumatiques Michelin/Commission, in ECR, 2003, II-04071, §§ 239-245.}

### 3.2. The discriminatory character

Regardless of their potential exclusionary effect, loyalty discounts have traditionally been considered incompatible with Article 82, lett. c), EC because of their inherently discriminatory character. In \textit{Michelin I}, the ECJ underlined the necessity to demonstrate that the disparity of treatment among clients stems from the application of
different criteria and is not justified by legitimate commercial reasons. However, in most cases the discrimination has been considered in re ipsa, since two undertakings that have purchased the same amounts may receive different discounts, depending on whether they have reached the thresholds set by the supplier. Under this approach, the dominant undertaking bears the burden of proving that discounts granted to buyers are not discriminatory, for instance because they are aimed at remunerating services offered by distributors on the basis of objective and transparent criteria. Furthermore, the Community institutions have generally failed to carefully assess the existence of a significant distortion of competition in the downstream market. The distortion of downstream competition has been often affirmed on the basis of a summary analysis, while in other cases it has been simply presumed or even ignored.

Such a tough approach cannot be easily reconciled with established economic literature, according to which price discrimination effects are ambiguous and cannot be determined a priori. The practice may increase output and, sometimes, consumer welfare. Furthermore, price discrimination represents a typical competitive tool, capable of destabilizing collusive equilibria to the benefit of consumers. Under this point of view, imposing the burden of proving an economic justification on dominant undertakings may not only make it impossible for them to utilize an effective commercial tool, but also weaken price competition and facilitate tacit or express collusion, especially in oligopolistic and stagnant markets. In addition, in markets with very high fixed costs and low variable costs, charging higher prices to less price sensitive customers may constitute the most effective way to recover the investments. In such cases, marginal pricing would not represent a realistic option to cover fixed costs, whereas the adoption of a uniform price exceeding marginal costs might determine an output restriction and favor the entry of inefficient competitors.

Obviously, when the dominant undertaking’s customers are active in the same market, the application of dissimilar conditions may penalize some operators in comparison with others. However, financial advantages granted by a dominant undertaking do not appreciably affect customers’ competitive capacity, if they are not

---

48 In particular, consumer welfare increases if with a uniform price only customers whose demand is inelastic would buy the product, whereas price discrimination allows the dominant undertaking to sell additional units to more price-sensitive buyers, without lowering the price charged to the former: see J. CHURCH-R. WARE, Industrial Organization – A Strategic Approach, Boston, 2000, 165. On doubts and uncertainties surrounding the antitrust treatment of price discrimination, see, among others, R.A. POSNER, Vertical Restraints and Antitrust Policy, supra note ________.
49 The beneficial effects of price discrimination may be particularly significant in case of products covered by intellectual property rights: on the one side, the discrimination might allow the innovating firms to secure a higher share of the surplus generated by the invention, thus increasing their incentives to invest in research and development; on the other side, the practice might reduce the allocative inefficiencies generated by the adoption of a single monopolistic price.
material in comparison with total costs faced by the companies concerned. In sum, the discriminatory character of discounts not justified by corresponding cost-savings nor by services rendered by distributors, by itself, does not constitute a reliable reason to ban the practice, unless it is possible to demonstrate that price differentials appreciably distort competition in a downstream market.

3.3. The unfairness

In Michelin II, the Commission and the Court of First Instance (CFI) held that the contested discount system was unfair, in light of the lack of transparency and the discretionary application of the scheme by the dominant undertaking. According to the Commission, these features of the system made it possible for the dominant company to discriminate among buyers and created a state of uncertainty, which intensified the pressure on distributors and, as a consequence, increased the fidelity-inducing effect of the practice. In parte qua, the Commission’s decision seems to reflect the objective to safeguard fairness in commercial relationships, in line with the ordo-liberal tradition, rather than the intention to protect competition and consumer welfare. In any case, in the Commission’s reasoning the unfairness of the practice is strictly linked to its discriminatory character and foreclosure effect, so that the identification of a separate violation of Article 82 EC appears to be at least redundant.

3.4. The compartmentalization of the common market

In the Michelin II case, the Commission held that the contested system tended to compartmentalize the common market and discourage imports from other Member States, since only volumes bought from a company located in France were taken into account in the calculation of discounts. However, the occasional tendency to compartmentalize national markets does not seem a sound basis for the prohibition of loyalty discounts. In the modernized European antitrust scenario, the dogma of the common market integration is still relevant, but it seems to be recessive and instrumental to the primary objective of EC competition policy, i.e. the protection of competition as a means of fostering consumer interests. Obstacles to intra-Community trade should only be taken into account insofar as they translate into a

---

50 It has also been noted that loyalty discounts unconnected with the customer dimension and linked, to a certain extent, to distributors’ sale efforts might reduce the possible gap between small and large dealers, through the grant of lump sums which may be destined to promotional activities. See A. HEIMLER, supra note __.

51 See J. TEMPLE LANG-R. O’DONOGHUE, supra note __.


53 See, for instance, Guidelines on the application of Article 81(3) of the Treaty (2004/C 101/08), §§ 13 and 33. In Adalat, the CFI made it clear that “the aim of [Article 81 EC] is not to eliminate obstacles to intra-Community trade altogether”, so that the Commission is not allowed to attempt to achieve a result, such as the harmonization of prices in the common market, “by enlarging or straining the scope” of antitrust rules: see Court of First Instance, October 26, 2000, Case 41/96, Bayer AG c. Commission, in Foro it., 2001, IV, 78, § 174 and 179; on the CFI’s judgment, see R. PARDOLESI, C’era una volta in Europa: di antitrust comunitario, importazioni parallele ed idoli infranti, in Foro it., 2001, IV, 78. The reasoning of the CFI was endorsed by Court of Justice, January 6, 2004, Case 2 & 3/01 P, Commission/Bayer, in Foro it., 2004, IV, 421.
restriction of competition to the detriment of consumer interests. In any case, the risk of compartmentalization of national markets is strictly related to the exclusionary effects of the practice. If the analysis of foreclosure effects demonstrates that the practice is not really capable of precluding competitors’ access to clients in a given territory, it is not necessary to intervene to safeguard the objective of common market integration either.

3.5. The lack of an objective justification

In EC competition law, proving the existence of a credible business justification for the use of loyalty discounts has always been extremely difficult, if not impossible. Fidelity and target discounts are not considered justified by economies of scale, since they are customer-specific and not based on objective amounts. Accordingly, a small buyer that achieves the thresholds set by the supplier may benefit from higher discounts than a customer that buys larger amounts, but is not equally loyal to the dominant undertaking. Further business justifications submitted by the parties have not been accepted. In particular, the EC courts have held that the limitation of the freedom of action of distributors is not justified by the need to: (i) plan production activities; (ii) limit imports that endangered the regularity and reliability of supplies by destabilizing national markets; (iii) stimulate distributors’ promotional efforts; and (iv) reward customers for the issuance of a guarantee.

In EC competition policy, discounts granted by a dominant undertaking seem to be justified only when they are conditioned on the achievement of standardized turnover thresholds and reflect cost-savings. This approach, based on a questionable interpretation of the concept of competition on the merits, reflects a naïve vision of the competition process and market dynamics: i.e., the idea that suppliers compete for any single order, day by day, on the basis of price and quality. In the real world, economic operators interact over longer time periods and attempt to establish stable relationships with customers. To this end, loyalty discounts represent a fundamental competitive


58 Court of Justice, February 13, 1979, Case 85/76, Hoffmann-La Roche/Commission, in ECR, 1979, 965, § 96. In Enel Trade, the Italian Competition Authority rejected the parties’ contention that the practice was justified by the need to guarantee demand stability, so as to minimize the so-called volume risk caused by the take or pay obligations provided for by energy supply contracts entered into by the dominant company: see decision of the Italian Competition Authority of November 27, 2003, No. 12634 (A333), Enel Trade-Clienti Idonei, in Bollettino No. 48/2003. By contrast, the judgment of the Regional Administrative Court of Lazio in the Telecom case seemed to suggest that competition authorities should take into account the fact that the discounts were imposed by clients with particular buying power: see TAR Lazio, Sez. I, February 22, 2005, No. 3655, available on the website www.giustizia-amministrativa.it; contra, see Consiglio di Stato, Sez. VI, March 10, 2006, No. 1271, in Il Foro Italiano, 2006, 512.

59 See B. SHER, supra note __.
tool, which may be more effective and less costly than other forms of incentives and promotional activities aimed at strengthening commercial relationships with clients.\textsuperscript{60}

3.6. Conclusions on the traditional approach of the Community institutions

A close look at EC competition policy reveals that the traditional (almost) \textit{per se} condemnation of loyalty discounts is unjustified and anachronistic. It is unjustified because, notwithstanding the procompetitive effects of the practice, antitrust intervention is based on a mere tendency to induce loyalty and to make it more difficult for rivals to access the market, regardless of: (i) the possibility for competitors to match the offer of the dominant firm, (ii) the degree of foreclosure, in relation to the minimum efficient scale required to operate on the market, and (iii) the impact of the possible exclusion on the level of competition and consumer welfare. It is anachronistic because the strict attitude of the Community institutions reflects some further values, such as the protection of economic freedom of dealers, fairness in commercial relations and the integration of national markets, which seem to be recessive in current antitrust practice.

4. The Discussion Paper

In its recent Discussion Paper,\textsuperscript{61} the Commission recognized that the competitive risks inherent in loyalty discounts lie in the fact that a dominant supplier may use the inelastic or non-contestable portion of the demand of each buyer as leverage to decrease the effective price for the elastic or contestable portion of demand. Accordingly, the Discussion Paper suggests a sophisticated price test, which is basically aimed at verifying whether the rebate system hinders “as efficient” competitors from entering the market or expanding their sales. According to the Discussion Paper, as a first step, the Commission would endeavor to calculate how big a share of customers’ requirements on average an entrant should capture so that the effective price is at least as high as the average total cost (ATC) of the dominant company (so-called “required share”). Then, it would compare the required share to a so-called “commercially viable share” of individual clients’ requirements, defined as “the share of customers’ demand an efficient entrant can reasonably be expected to capture”.\textsuperscript{62} In this last regard, the Discussion Paper states that, as a general rule, the Commission would first assess what is the effect of the discount system on a company that wants to enter at minimum efficient scale, based on the assumption that it would sell the same percentage to each customer in the market.

\textsuperscript{60} See A. HEIMLER, \textit{supra} note __.

\textsuperscript{61} The Discussion Paper distinguishes between conditional discounts (\textit{i.e.}, schemes where the price charged is linked to a customer condition, such as meeting a sales threshold) and unconditional discounts (\textit{i.e.}, a straightforward price reduction with no conditions attached) (see § 171). With regard to the treatment of conditional rebates, the Discussion Paper further distinguishes between conditional discounts on incremental purchases above a given threshold and conditional discounts granted on all purchases in the reference period (§ 151). Loyalty discounts discussed in this paper are included in the latter category (retroactive conditional discounts). Regarding unconditional discounts, the Discussion Paper proposes to apply the usual rules on predatory pricing (§ 151). For incremental conditional discounts, the Discussion Paper employs a predation standard, with the important difference that the cost threshold proposed for the assessment of predatory pricing is the average avoidable cost, whereas in the analysis of this form of discounts the Commission makes reference to the average total cost.

\textsuperscript{62} See Discussion Paper, § 156.
Where the required share exceeds the commercially viable share, the discount practice is deemed likely to have a foreclosure effect, as the effective price resulting from the discount system over this commercially viable share is below the ATC of the dominant company. If the estimated commercially viable share is smaller than the required share, the Commission would continue to investigate whether this first estimate is not too low, for instance because competitors’ entry or expansion is likely to occur at a larger scale than the minimum efficient scale, or because entrants are likely to concentrate sales on a limited number of customers to whom they can sell more per customer.

If the Commission concludes that the required share exceeds the commercially viable share, it would further assess whether the dominant company applies the rebate system to a significant part of its buyers, thus affecting a substantial portion of market demand. In addition, the Commission would also verify whether there are clear indications of a lack of foreclosure effect, such as significant entry or expansion by competitors or switching of customers. In case it is not possible to accurately establish the required share or the commercially viable share, the Commission would try to assess to what extent the system hinders expansion or entry by rivals, by investigating the market performance of the dominant company and its competitors, their situation before and after the introduction of the practice, the size of the discounts and the indications of an actual foreclosure effect.

The Discussion Paper also addresses the concept of business justification. The Commission explicitly recognized that exclusionary conduct should escape the prohibition of Article 82 in case: (i) the dominant undertaking can provide an objective justification for its behavior, or (ii) it can demonstrate that its conduct produces efficiencies which outweigh the negative effect on competition. However, with specific regard to discount and rebate policies, the Discussion Paper adopted a very cautious approach. According to the Commission, as a general rule, rollback discounts based on individualized thresholds are not justified by cost advantages or by the need to incite customers to purchase and resell higher volumes. By contrast, it seems that loyalty discounts may be justified by the need to protect dominant suppliers’ customer-specific investments.

---

63 Ibid. However, in the Discussion Paper the Commission clarifies that it may exceptionally conclude that a market distorting foreclosure effect results even if the effective price is above ATC. In particular, this may be the case if the dominant company operates in a market where it has certain non-replicable advantages: see § 165.
65 Id., § 162.
66 Ibid.
67 Id., § 164.
68 The Commission identified two types of objective justifications: the first type is where the dominant company is able to show that the otherwise abusive conduct is actually necessary on the basis of objective factors (‘objective necessity defense’); the second type is where the dominant company is able to show that the otherwise abusive conduct is actually a loss minimizing reaction to competition from others (‘meeting competition defense’). See Discussion Paper, §§ 77-83.
69 Id., §§ 84-92.
70 Id., §§ 173-174.
71 Id., § 175.
Although the implementation of the price test devised by the Discussion Paper is extremely complex and raises delicate questions on the safeguard of legal certainty,\textsuperscript{72} the introduction of a standard based on the capacity to exclude equally efficient competitors would represent a first step in the right direction. Furthermore, the Discussion Paper demonstrates that the Commission intends to analyze more carefully the extent of foreclosure and the actual impact of the practice on entry and expansion by competitors.

However, some features of the price test proposed by the Commission are open to debate. The concept of commercially viable share appears too vague and discretionary. As a general rule, the possibility to match the dominant firm’s offer should be assessed on the basis of the entire contestable portion of the customer’s requirements.\textsuperscript{73} There is no reason to presume that a company willing to enter a market or expand its operations sell the same percentage to each customer in the market. To the contrary, it may well be possible that, in most cases, it will try to sell larger amounts to a limited number of customers. The Discussion Paper recognizes that, in some cases, it may be necessary to revise the estimate of the commercial viable share upward. Furthermore, it gives the parties the possibility to rebut the Commission’s preliminary conclusion, by showing that entry or expansion of competitors is not limited to the amount assessed by the Commission as the commercially viable share.\textsuperscript{74} However, the amount assumed as a starting point by the Discussion Paper in the calculation of the commercially viable share seems to establish a presumption that may lead to many false positives and discourage an effective form of price competition.

5. Recent developments: the Tomra case and the British Airways judgment

Although the Discussion Paper seemed to be a prelude to a move towards a more effects-based analysis, the decision of the Commission in the Tomra case and the British Airways judgment of the ECJ made it clear that the Community institutions are still reluctant to depart from established case law. In Tomra,\textsuperscript{75} the Commission analyzed a series of retroactive rebate schemes implemented by a dominant supplier of reverse vending machines.\textsuperscript{76} The Commission did not attempt to appraise the contestable portion of the customers’ demand, nor did it try to measure the required share and the commercially viable share of their requirements, in accordance with the test proposed in the Discussion Paper. It merely estimated the minimum unit price a

\textsuperscript{72} The lack of legal certainty may lead dominant firms wishing to comply with Article 82 EC not to make use of conditional rebate schemes, even where they enhance consumer welfare. This is particularly troublesome in innovative and dynamic industries: see C. AHLBORN-V. DENICOLÒ-D. GERADIN-A.J. PADILLA, DG Comp’s Discussion Paper on Article 82: Implications of the Proposed Framework and Antitrust Rules for Dynamically Competitive Industries, March 31, 2006, available on the website www.ssrn.com.
\textsuperscript{73} See above, § 2.1.
\textsuperscript{74} See Discussion Paper, § 163.
\textsuperscript{76} Reverse vending machines are used by supermarkets to collect empty beverage containers from, and return deposits to, consumers.
competitor would need to offer on a per unit basis in order to match the dominant company’s price under the rebate systems. Then, it noted that, given the retroactive character of the rebate schemes, rivals could be forced to offer very low or even negative prices for the last units before the thresholds were reached.

Tomra argued that even in the worst case scenario, where a rival competes for only the last unit before the threshold is reached, an equally efficient competitor could be able to compensate a customer for the loss of the rebates by offering a low average price, provided that demand is sufficiently above the threshold. The Commission objected that the last unit before the threshold is reached would be sold at a negative price and, therefore, this sale would entail a loss for the competitor. The latter would earn more profits by selling only the units above the threshold. Accordingly, a rational competitor would simply forgo the sale of the extra unit at a negative price.

The Commission’s analysis seems to overestimate the impact of the practice on the market. The unit price of the last units before the threshold is reached, by itself, does not say much about the foreclosure effect of a discount scheme. A rival could match the dominant company’s offer by absorbing the retroactive discount not only over the units that lie above the threshold, but also over contestable units below the threshold. If the contestable portion of the customer’s demand below the threshold is sufficiently large, competitors might earn more profit by selling many units at a lower price, rather than only the units above the threshold at a higher price.

Although the Tomra decision has been depicted as an important step towards the envisaged reform of Article 82 enforcement, it seems to confirm – with some refinements – the traditional approach of the Community institutions, according to which the prohibition of loyalty discounts is justified by their mere tendency or abstract capability to exclude competitors.

The following year, the judgment of the ECJ in the British Airways case, released on March 15, 2007, seemed to further reinforce the traditional EC enforcement policy. The ECJ stated that, in determining whether a loyalty discount scheme constitutes an abuse of dominance under Article 82, a two-step test must be applied. As a first step, it must be determined whether the practice can produce an exclusionary effect, i.e. whether it is “capable, first, of making market entry very difficult or impossible for competitors of the undertaking in a dominant position and,

---

77 According to the Commission, in the market concerned, it was unlikely that a customer would immediately buy large quantities from a company that had just entered the market, since it was normal practice for customers to test the product first and, subject to a satisfactory result, decide whether to purchase more units. Although this characteristic of the market might have delayed competitors’ access or expansion to a certain extent, the Commission’s analysis does not demonstrate that rivals did not have the chance to establish themselves in the market by offering better products or lower prices. As the thresholds did not exactly correspond to the entire requirements of individual customers, competitors could in any case sell some units to clients willing to differentiate their supply sources, in order to make them test competing products.

78 Indeed, the margins on additional sales may well outweigh the cost of having to compensate a customer for failing to meet the threshold. Interestingly, in the Discussion Paper the Commission itself noted that “[t]he 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 a 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” (see § 154).

79 See F. MAIER-RIGAUD-D. VAIGAUSKAITE, supra note __.

secondly, of making it more difficult or impossible for its co-contractors to choose between various sources of supply or commercial partners.”. Then, one must examine whether an objective economic justification for the discounts and bonuses granted exist.

According to the ECJ, the loyalty bonuses offered by British Airways to its travel agents had an exclusionary effect, due to two main factors: (i) the retroactive character of the bonus schemes produced a “very noticeable effect at the margin”, thus exerting a significant pressure on travel agents; (ii) given the much larger market share of the dominant company, it was reasonable to presume that rival airlines were not in a position to grant travel agents the same advantages as British Airways, since the level of revenue they attained in the United Kingdom did not constitute a sufficiently broad financial base to establish a comparable reward scheme.

Neither the Commission nor the CFI tried to estimate whether the incremental price of contestable units of agents’ demand was below an appropriate cost benchmark. Nevertheless, the ECJ held that the analysis of the exclusionary effect was supported by sufficient factual elements and economic evidence, as the CFI’s judgment made explicit reference to the calculations contained in § 30 of the Commission decision. In the contested decision, the Commission estimated the effect of the system on a competitor wishing to give a travel agent an incentive to divert 1% of its sales from British Airways to the competing airline. Not surprisingly, the Commission found that, in order to compensate the agent for the loss of the bonus on the entire turnover relating to British Airways’ tickets, a competing airline had to pay a much higher rate of commission on its tickets. The question remains unanswered whether competitors could match the dominant company’s offer by absorbing the bonus over a larger amount of tickets.

The ECJ was also satisfied that the CFI took into account all relevant circumstances in assessing the foreclosure effect of the practice. Actually, the increase of rivals’ sales during the implementation of British Airways’ commission schemes cast significant doubts on the exclusionary effect of the practice. However, the ECJ stated that it could not substitute its appraisal of market conditions and competitive situations for that of the CFI. Eventually, the ECJ endorsed the reasoning of the CFI and the Commission, without investigating in more detail whether they had adequately assessed the possibility for rivals to match British Airways’ offer, the extent of foreclosure and the existence of effective alternative distribution channels.

The British Airways judgment does not prevent the Commission from adopting a standard based on a more accurate and rigorous analysis of foreclosure effects of loyalty discounts. The ECJ explicitly recognized that a mere fidelity-building effect is not sufficient to establish an abuse of dominance, absent the proof of an exclusionary effect. Nevertheless, the British Airways judgment might curtail the spur to innovate that inspired the adoption of the Discussion Paper. The endorsement of a typical old-

---

81 Id., § 68.
82 Id., §§ 73-74.
83 Id., §§ 75-76.
85 Court of Justice, March 15, 2007, Case C-95/04, British Airways/Commission, available on the website www.curia.europa.eu, § 77, where the ECJ makes reference to “a fidelity-building effect capable of producing an exclusionary effect”.

---
style decision demonstrates that the ECJ does not consider it indispensable to improve
the economic analysis of loyalty discounts and to raise the current standard of proof.
Furthermore, as noted by Advocate General Kokott in his opinion, even if the
Commission’s administrative practice were to change, the latter would still have to act
within the framework of Article 82 EC as interpreted by the ECJ. In order to overcome
the current impasse in the review of Article 82 enforcement, the Commission might
eventually decide to codify, with some refinements, the traditional approach of the
Community institutions.\textsuperscript{86} This would be unfortunate, as the Commission would not
only lose an opportunity to define a more rigorous and coherent abuse standard, but
also prejudice, to a certain extent, the future evolution of its decision practice in the
field of loyalty discounts.

6. The antitrust assessment of loyalty discounts: a proposed structured rule of
reason

Although loyalty discounts may discourage the differentiation of supply
sources, the issue is when they raise serious barriers to entry, so that the prohibition of
an effective competitive tool is justified. Assessing the exclusionary effect of a loyalty
discount scheme is extremely complex. In principle, the possibility to match the
dominant company’s offer should be verified on a customer-by-customer basis, by
estimating the incremental price of the contestable portion of clients’ demand. In case
such price is not predatory, it would be further necessary to establish whether rivals
would be interested in competing for units below the threshold or would be simply
better off by selling only units above the threshold at a higher price.\textsuperscript{87} However, the
difficulty of ascertaining the competitive impact of the practice does not justify an
almost per se ban. As a typical form of price competition, the grant of discounts should
benefit from a presumption of legality, which should be rebutted only when the practice
may exclude equally efficient competitors. If loyalty discounts cannot exclude an
equally efficient competitor, the prohibition of the practice may result in the protection
of minor rivals’ profitability and market position, with the consequence of lessening
price competition and raising the costs of the sector concerned.

Under exceptional circumstances, the prohibition of loyalty discounts might
increase economic efficiency even though the practice is not capable of excluding
equally efficient competitors. Where significant scale, scope or learning economies
exist, a potentially equally efficient competitor would not be able to compensate
customers for the loss of discounts, if the commercial policy of the dominant company
prevents it from achieving adequate efficiency levels. Similarly, when an economic
activity implies significant sunk costs, the incumbent could prevent entry by fixing a
price that exceeds its cost but is not remunerative for new entrants. However, several
factors cast doubts on the prohibition of discounts unable to exclude equally efficient
competitors. First, in the above-mentioned cases, the remedy might be more harmful
than the problem itself. The antitrust intervention aimed at preventing the exclusion of
potentially equally efficient competitors would at the same time protect inefficient
companies and discourage competitive initiatives, thus favoring high price levels.

\textsuperscript{86} See F.P. MAIER-RIGAUD, \textit{Article 82 Rebates: Four Common Fallacies}, available on the website
www.ssrn.com, according to whom “[g]iven the limited use and scarcity of the literature one has to
wonder whether there is a reason to alter the policy on rebates under Article 82”.

\textsuperscript{87} See above, § 2.1.
collusive equilibria and productive efficiency losses. Secondly, if capital markets work properly, a potentially equally efficient competitor should be able, in theory, to procure resources necessary to finance a start-up period of below cost sales. Thirdly, in recently liberalized markets where the need to protect newcomers and minor competitors is more intense, the issue could be resolved through ad hoc regulatory measures, thus avoiding the creation of precedents that might influence the application of competition rules in other sectors. Finally, it may be extremely difficult, if not arbitrary, to determine the cost level of an efficient new entrant.88

In any case, the capacity to exclude (potentially) equally efficient competitors, by itself, does not justify the prohibition of the practice. First, a discount system does not erect significant barriers to entry or expansion if competitors can use alternative distribution channels, sell directly to final consumers or integrate vertically. Secondly, the obstacle to rivals’ entry or expansion does not translate automatically into a prejudice to consumer interests, if competitive constraints remaining on the market are sufficient to prevent the exercise of market power by the dominant undertaking.

In light of the above, it is submitted that the (almost) per se rule against loyalty discounts should be set aside. Loyalty discounts should be assessed on the basis of a structured rule of reason, aimed at establishing the following three conditions: (i) the capability of the scheme to exclude or limit the competitive capacity of rivals, through the grant of discounts that cannot be matched by equally efficient competitors and determine significant foreclosure effects; (ii) the negative impact of such exclusion on the overall degree of competition in the market; and (iii) the lack of an objective justification.

6.1. The capability to exclude or limit the competitive capacity of equally efficient competitors

The capacity to exclude or limit the competitive capacity of equally efficient competitors depends on two factors: (i) the capacity to prevent equally efficient companies’ access to customers covered by the discount system; (ii) the extent of foreclosure, taking into account the minimum efficient scale to operate in the market concerned.

6.1.1. The capacity to prevent equally efficient companies’ access to customers covered by the discount system

In order to establish whether a discount system prevents equally efficient rivals’ access to customers, it is necessary to estimate the incremental price applied by the dominant firm for the contestable share of the customer’s demand, by allocating on this

---

88 Reference to actual competitors’ cost level would not be adequate, as the prohibition of the practice could protect inefficient firms. In addition, the dominant company might not be aware of rivals’ costs, so that it could be inequitable to fine a company for having offered prices lower than competitors’ cost level. On the reasons suggesting not to intervene in case of above cost exclusion, see, among others, A. MAJUMDAR-S. BISHOP-D. RIDYARD-I. WILLIAMS-U. AKGUN, supra note __. Contra, see F.P. MAIER-RIGAUD, Article 82 Rebates: Four Common Fallacies, supra note __, on the ground that even an inefficient competitor constitutes a competitive constraint on the dominant firm and thereby is likely to increase consumer welfare.
share the entire discount granted by the supplier.\textsuperscript{89} If the incremental price is lower than an appropriate measure of cost, the discount or rebate scheme might have exclusionary effects, since “as efficient” rivals may be unable to match the dominant firm’s offer. In the negative case, the system should be presumed lawful.\textsuperscript{90} However, competition authorities and plaintiffs should have the possibility to prove that, although the incremental price for the contestable portion of demand is not predatory, rival suppliers would not have sufficient incentives to compete for the units below the threshold, as they would earn more profit by selling only the units above said threshold at a higher price.

The analysis is more complex – but not materially different – in case of retroactive systems based on a grid of progressive thresholds linked to increasing discount rates. In these cases, the failure to achieve a certain threshold might not imply the loss of any discounts, but only the application of a lower discount rate, corresponding to an inferior threshold. Accordingly, it would be necessary to verify not only the predatory character of the incremental price of the contestable share of the customer’s demand, but also the possibility to compete for lower portions of his requirements.\textsuperscript{91}

\textsuperscript{89} See above, § 2.1. This test is consistent with the one suggested by G. FEDERICO, \textit{supra} note __. The Author proposes to estimate the average price a competitor would have to practice for any given quantity to make customers indifferent between the rival’s and dominant company’s offers. Then, such price schedule should be compared to an efficient entrant’s average variable and average total cost schedules, over the quantity range that a rival seller could credibly contest from the dominant firm. \textit{Contra}, on the basis of the same arguments on which the \textit{Tomra} decision is grounded, see F.P. MAIER-RIGAUD, \textit{Article 82 Rebates: Four Common Fallacies, supra} note __.

\textsuperscript{90} In the economic literature, some further predation-style cost-tests have been suggested. In particular, it has been proposed to estimate the discount that should be offered by a hypothetical rival wishing to realize a small but significant increase of its sales, equal to 5 percent of the customer’s demand. See A. HEIMLER, \textit{supra} note __. However, there is no reason to limit the analysis of the possibility to match the dominant undertaking’s offer to a small but significant increase in sales, if there are no additional factors – such as brand loyalty and capacity constraints – preventing rivals from competing for larger portions of the customer’s demand. Other antitrust scholars have proposed to define a kind of “battle field” by aggregating the contestable portion of all customers’ demand, in order to apply a price test in this share of the market. The practice would be unlawful when the average incremental price was higher than the average incremental cost. See A. FLETCHER, \textit{Loyalty Rebates Schemes: towards an effects-based approach?}, Second conference of the Association of Competition Economics, Siena, December 2-3, 2004, and \textit{The reform of Article 82: recommendations on key policy objectives}, speech at the Competition Law Forum, Brussels, March 15, 2005, available on the website www.oft.gov.uk. However, this test would not prohibit the practice when the incremental price, on average, was not predatory, even if the system prevented access to the most efficient distribution channels. Others have underlined that, in the case of rollback discounts, above a certain threshold the incremental sales necessary to achieve the target set by the dominant undertaking do not contribute to increasing its total profits. If the assured base of sales exceeds this threshold, the dominant company would earn more profits without the discount system and, therefore, the incremental price should be deemed predatory. To the contrary, if the assured base of sales does not exceed the above-mentioned threshold, it should be presumed that the practice is lawful, since the price of the contestable portion of the customer’s demand would be higher than an appropriate cost measure. See A. MAJUMDAR-S. BISHOP-D. RIDYARD-I. WILLIAMS-U. AKGUN, \textit{supra} note __.

\textsuperscript{91} It should be noted that, under conditions of stochastic demand, a progressive discount system may be more effective and harmful than a scheme providing for a single turnover threshold. The latter might turn out to be too high or too low in comparison with the customer’s requirements, whereas a grid of progressive thresholds linked to increasing discount rates would provide incentives to purchase from the dominant company regardless of possible demand fluctuations.
Needless to say, the assessment of the exclusionary effect of loyalty discounts is extremely complex. The application of a price-cost standard requires a complete and detailed set of information and data about customers’ purchasing behavior, consumers’ preferences and the costs of the dominant undertaking. Such data and information might not be easily available. In addition, the predatory character of the incremental price should be analyzed, in principle, on a customer-by-customer basis. When there are several customers, their purchasing behavior is heterogeneous and they cannot be grouped into a limited number of categories, it may be almost impossible to establish with a sufficient degree of certainty whether the discount system precludes rivals’ access to a large share of the market. Nevertheless, in order to ascertain the competitive impact of loyalty discounts, antitrust authorities and courts should carry out a price-cost analysis as complete and accurate as possible, since the demonstration of the predatory character of the scheme at the margin is the only solid basis to prohibit a classical form of price competition. When it is impossible to estimate with an acceptable degree of approximation the level of the incremental price and/or cost due to a lack of sufficient data, the practice should be presumed lawful, unless it is possible to prove tangible anticompetitive effects.

The most critical issues in the assessment of the capacity to prevent equally efficient competitors’ access to clients are the following: (a) the relevance and the critical duration of the reference period; (b) the determination of the contestable portion of customers’ demand; and (c) the definition of the cost benchmark to be compared with the incremental price offered by the dominant company.

(a) The reference period

Although the state of the law seems to be still fluid, the duration of the reference period is usually deemed an important factor in the analysis of the exclusionary effect of a loyalty discount scheme. The communis opinio is based on the assumption that switching costs become higher as the duration of the reference and the time already elapsed increase.\(^{92}\) However, the duration of the reference period is not a reliable indicator of the exclusionary effect of a loyalty discount scheme. Assuming that firms compete for the entire requirements of the client, the level of switching costs is a function of the discount rate and the amount of purchases from the dominant company already made at any particular moment.\(^{93}\) This amount is generally correlated to the passing of time, so that switching costs tend to be higher towards the end of the reference period. Furthermore, as the customer draws close to the threshold set by the dominant company, the contestable portion of his requirements decreases, thus obliging rivals to distribute the discount over lower volumes. Accordingly, the increase of purchases already made and, indirectly, the passing of time tend to strengthen the potential exclusionary effect of a retroactive discount

---

\(^{92}\) As already noted, the European Courts’ case law does not provide clear indications as to the critical duration of the reference period. The legal and economic literature is characterized by a similar uncertainty: according to some commentators, there is no reason to grant rebates after the expiration of the terms for the payment (see C. ROQUES, supra note __). Others have held that the critical duration of the reference period cannot be established ex ante. It should be determined case-by-case on the basis of the frequency of orders in the sector concerned, in order to verify whether the system determines the bundling of a significant number of purchases: see L. GYSELEN, supra note __.

\(^{93}\) See F.P. MAIER-RIGAUD, supra note __.
scheme, because they increase switching costs and reduce the contestable portion of customers’ demand. However, the time elapsed since the beginning of the reference period represents only an indirect indicator of the purchases already made and, therefore, of the level of switching costs. The reliability of such relationship depends on the features of the industry concerned and, in particular, on the regularity of supplies.  

That being said, the relevance of the purchases already made and, indirectly, of the passing of time depends on the degree of contestability of the customer’s demand. The amount of purchases already made during the reference period affects the level of switching costs and the size of the contestable share of customers’ demand only after such purchases exceed the assured base of sales. If a significant share of a customer’s requirements is monopolized, the amount of purchases already made during the reference period is not very important. In the opposite case, when the entire customer’s demand is contestable, the time already elapsed since its beginning may be an indicator of the level of switching costs and the size of the contestable share of the customer demand. Furthermore, the duration of the reference period indicates the intervals at which firms compete on an equal footing.

However, if a large part of the customer’s requirements is contestable, even a significant duration of the reference period – equal, for instance, to one year – should not raise intolerable barriers to entry or expansion. Firstly, in the initial part of the reference period an equally efficient competitor should be able to match the dominant company’s offer. Secondly, in any case rivals can compete on an equal footing at the beginning of each reference period. A one-year reference period might delay competitors’ access or expansion for some months, but at its expiration rivals would be conscious of the dominant company’s strategy and could adjust their commercial policy accordingly. Longer reference periods could theoretically be more harmful to competitors, but might turn out to be impractical or ineffective, as the supplier would not be able to frequently adapt the thresholds to market changes and demand fluctuations. As a consequence, for a loyalty discount practice to be have significant exclusionary effects, as a general rule it is necessary that a form of asymmetry between competitors exist, which prevents minor companies from competing for a significant share of customers’ requirements.

(b) The identification of the contestable portion of customers’ requirements

\[\text{footnote text} \]

\[\text{footnote text} \]

\[\text{footnote text} \]
In actual practice, it may be extremely difficult to establish the assured base of sales. The latter may not be easily observable and may vary significantly across customers. Data concerning past years (absent changes in the main variables affecting demand) and surveys on habits and preferences of customers and final consumers may provide important evidence. In case of brand loyalty phenomena, a high market share held by the dominant firm may be indicative of the existence of a significant assured base of sales. When it is possible to conclude that the assured base of sales is on average overestimated and the incremental price of the contestable portion of demand is not predatory, the practice should benefit from a presumption of legality.

However, the assessment of the assured base of sales may turn out to be too complex and uncertain, due to the existence of a high number of clients with heterogeneous needs and preferences. In this case, competition authorities and courts may only base their assessment on available circumstantial evidence. Under this point of view, the expansion of competitors' market shares and the existence of cases in which a rival won part of a customer’s requirements from the dominant company, notwithstanding the discount system, may indicate that the incremental price of the contestable share of demand is not predatory.

(c) The definition of an appropriate measure of cost

The definition of an appropriate measure of cost constitutes one of the most controversial issues in the application of any price-cost test for predation. In economic literature and actual practice, many different measures of cost have been explored, namely: average total cost (ATC); marginal cost (MC); average variable cost (AVC), average incremental cost (AIC) and average avoidable cost (AAC). With specific regard to loyalty discounts, it has been proposed to make reference to avoidable or, as an alternative, incremental costs incurred by the dominant company to produce units included in the contestable share of sales, within a time period equal to the reference period or longer, if the discount scheme is constantly renewed at its expiration. Such approach would exclude from the computation of the cost level all costs that would be sustained in any case to produce the units destined to cover the assured base of sales. Accordingly, the dominant undertaking could benefit from the possibility to allocate common costs entirely on the assured base of sales. To the contrary, competitors should take into account these costs in the determination of prices offered for the contestable share of customers’ requirements. Taking into account that the price-cost test should function as a safe harbor, it could be preferable to make reference to a prudential measure, such as avoidable or incremental costs incurred to produce units destined to cover both the assured base of sales and the contestable portion of the market.

In the Discussion Paper, the Commission adopted a much more cautious approach. The Commission proposed to take ATC as the cost benchmark below which a discount system is considered exclusionary, because “leveraging between the ‘non-
contestable’ and the ‘contestable’ portion of demand allows the rebate system to operate without a profit sacrifice and thus to operate for a long time”. The Commission’s reasoning is not entirely convincing. In many markets, competitors with a similar cost structure may also be able to price below ATC for a long time, provided that AAC or AIC are covered. In such cases, the Commission’s approach would provide firms with an unnecessary price umbrella. Furthermore, the combination of such a rigorous cost benchmark and a cautious attitude in the measurement of the so-called commercially viable share may eventually result in a significant degree of over-deterrence.

6.1.2. The extent of foreclosure

Even if equally efficient competitors cannot match the dominant company’s offer, for a discount system to have an appreciable exclusionary effect it is necessary that the practice prevents access to a significant portion of the market and raises significant barriers to entry or expansion. Competition authorities and courts should investigate a series of additional factors, such as the number and market share of tied clients, the portion of their requirements covered by the loyalty discount scheme, the existence and the degree of efficiency of alternative distribution channels, and the possibility to integrate vertically and/or sell directly to final consumers.

The extent of foreclosure justifying an antitrust intervention cannot be determined a priori. The analysis of barriers to entry and expansion should be based on the features of markets concerned, taking into account, in particular, the minimum efficient scale to compete effectively. In any case, it is not necessary to demonstrate that the loyalty discount system is capable of excluding competitors altogether from the market. The practice may raise rivals’ costs by preventing them from achieving scale economies or accessing the most efficient distribution channels. Similarly, the drop in residual demand caused by prevention of access to a significant portion of demand could diminish competitors’ expected profits and, therefore, their incentives to invest in new production capacity, research and development or promotional activities. Ultimately, the aim of the analysis is to verify whether the practice is capable of reducing the competitive pressure exerted by rivals.

103 This part of the test should not necessarily follow the analysis of the possibility to match the dominant company’s offer. If it appears clear from the outset that only a limited share of market demand is covered by the contested discount system, the case should be dismissed.
104 Under this perspective, discount systems providing for thresholds progressively rising year by year may be particularly harmful to competition, since they tend to saturate the buyers’ distribution capacity.
105 Direct sales may be a realistic option if buyers are large, scope economies and number of sales points are not very important and distribution activities provide little added value: see A. MAJUMDAR-S. BISHOP-D. RIDYARD-I. WILLIAMS-U. AKGUN, supra note __.
108 The evolution of market shares of the dominant undertaking and its rivals before and after the implementation of the practice, as well as the entry of new operators or the exit of existing competitors,
6.2. The impact of the practice on the overall degree of competition and on the market power of the dominant firm

In an approach based on the impact of the practice on (total or) consumer welfare, antitrust agencies and courts should also verify whether the exclusion or limitation of the competitive capacity of one or more rivals may reduce the degree of competition in the market, thus resulting in the strengthening or preservation of the dominant company’s market power. An integral part of this assessment should be the evaluation of the possibility of recoupment of profits lost during the implementation of the practice, because of the sale of some units at a predatory incremental price.

The assessment of the competitive impact of the practice requires a broad investigation into the structure and features of the market concerned, taking into account factors such as the degree of market power of the allegedly dominant firm, the strength of rivals affected, the presence of further competitors capable of exerting a significant competitive pressure and the extent of barriers to entry or expansion. Loyalty discount systems should be prohibited under competition rules only when they prevent actual or potential competitors from exerting a significant competitive pressure, thus giving rise to a price increase, a restriction of production, a deterioration of quality, a limitation of choices or a decrease in the innovation rate. Absent these conditions, an antitrust intervention would only protect minor competitors’ market position and profitability. Unfair competition rules would undoubtedly represent a more suitable instrument to safeguard the competitors’ position in such instances.

It is reasonable to presume that, if exclusion occurs, in most cases the practice will have an impact on competition and consumer interests. When a firm is already dominant, even a small decrease in the residual competitive pressure exerted by (one or more) rivals may give rise to significant competition concerns. Furthermore, in many cases the practice itself may raise strategic barriers to entry or expansion of competitors, thus lessening competition to the detriment of consumers. However, the causal link between injury to (some) competitors and harm to competition and consumers should be carefully assessed instead of being assumed a priori, especially in cases where the alleged dominant company is subject to significant competitive constraints.

As underlined by the OECD, “disadvantaging or even excluding competitors through the use of fidelity discounts need not harm consumers”: see OECD, supra note __, 8. See also J. KALLAUGHER-B. SHER, supra note __, proposing a three-stage standard aimed at verifying whether: (i) the discount system generates appreciable switching costs; (ii) these costs constitute a significant barrier to entry or expansion of competitors; and (iii) these barriers to entry or expansion are likely to cause anticompetitive effects, in terms of higher prices or limitation of the choices available to consumers.

This brings us a step forward. The main utility of the dominance test in EC competition law lies in the fact that a screening based on a legal concept similar to the economic notion of market power avoids the prohibition of many forms of pro-competitive unilateral conduct, thus reducing the number of false positives. The intent to prohibit certain unilateral practices by non-dominant companies led in some cases to an overtly broad interpretation of the notion of dominance or vertical agreement: in this last regard, see R. PARDOLESI, Intese restrittive della libertà di concorrenza, and G. FAELLA, Le intese verticali, in A. FRIGNANI-R. PARDOLESI (eds.), La concorrenza, in G. AJANI-G.A. BENACCHIO (eds.), Trattato di Diritto Privato e dell’Unione Europea, Torino, 2006, pp. 25 and 105. If we were confident in the analysis of the actual or likely impact of a practice on the market, there would be no need for a separate
6.3. The lack of an objective justification

Even though the contested conduct increases or protects the market power of the dominant company, the latter should be allowed to escape any liability by proving that the practice is justified, because it is objectively necessary or determines prevailing efficiency gains, which cannot be attained through less restrictive means. The concept of objective justification has always been interpreted narrowly by the Commission and European courts.\textsuperscript{111} Furthermore, the notion of abuse inherited from the ordo-liberal tradition, focused on the departure from a vague paradigm of competition on the merits, has left little room for efficiency considerations in the assessment of unilateral conduct under Article 82.\textsuperscript{112} Efficiencies have been generally taken into account only insofar as they translated into a form of performance-based competition. Although the Discussion Paper contains some cautious openings,\textsuperscript{113} the Commission seems still reluctant to recognize that rollback discounts based on individualized targets may respond to legitimate business considerations.

In particular, according to the Community institutions, loyalty discounts are not justified by cost savings, because they are not conditioned on the achievement of objective amounts. Small customers may receive larger discounts than bigger clients, if the latter have not reached the thresholds set by the supplier. However, a system based on individualized thresholds might allow firms to realize much larger scale or scope economies than a simple quantity discount scheme. Individualized thresholds allow the dominant undertaking to increase purchases of all customers, regardless of their dimension and the level of their requirements, whereas discount systems based on objective thresholds may not provide all clients with adequate incentives. If suppliers bear the burden of proving that discounts exactly correspond to cost savings made possible by single orders of each customer, the possibility to realize important cost savings may be denied. Furthermore, a loyalty discount system might be justified by several additional legitimate business reasons, such as the intent to stimulate dealers’ sale efforts and promotional services, protect relationship-specific investments, prevent free-riding by competing suppliers or implement a form of second-degree price discrimination.\textsuperscript{114} In many cases, there may be less restrictive but equally practical pricing instruments or other means to achieve the same efficiencies.\textsuperscript{115} However, competition authorities and courts should give dominant companies the opportunity to demonstrate that a loyalty discount system producing exclusionary effects is objectively justified.

7. Conclusions
Under particular conditions, loyalty discounts may have an exclusionary effect. However, in many markets, they represent a common practice used by non-dominant firms to achieve perfectly legitimate commercial objectives. Loyalty discounts constitute a classical form of price competition, an effective commercial tool and a way to solve coordination problems in the production chain. In many cases, alleged efficiencies made possible by loyalty discount schemes may be difficult to quantify or may be attained through alternative and less restrictive instruments. However, the existence of several legitimate business explanations for the use of the practice suggests that the intervention of antitrust authorities and courts should be especially cautious.

The actual competitive impact of loyalty discounts may be extremely difficult – and, sometimes, even impossible – to ascertain with a sufficient degree of certainty. Nevertheless, the difficulty of establishing the competitive impact of the practice does not justify the almost per se ban adopted by Community institutions, nor the per se legality of all non-predatory discounts suggested by some US courts. A structured rule of reason, based on a suitable price-cost test and a careful assessment of the impact of the practice on the competitive capacity of minor rivals and on the overall degree of competition in the market concerned, would allow to intervene in cases of seriously exclusionary discount policies, while limiting the unnecessary prohibition of effective forms of price competition. When a lack of sufficient data and information makes it impossible to estimate with an acceptable degree of approximation whether the incremental price of the contestable units of customers’ demand is below an appropriate cost benchmark, loyalty discounts should be presumed lawful, unless it is possible to prove, also on the basis of clear and convincing circumstantial evidence, that the practice caused tangible anticompetitive effects.

In the Discussion Paper, the Commission attempted to deal with the complex issues raised by the economic analysis of loyalty discounts, but the decision delivered in the Tomra case and the Virgin/British Airways judgment seemed to reinforce the traditional approach of EC institutions, according to which a mere tendency to induce loyalty and hinder competitors is enough to justify the prohibition of the practice. However, the EU antitrust system does not need a restatement or a refined version of the conventional almost per se approach. What we need is an effort to develop a better abuse standard, through the definition of sound guiding principles to be implemented and specified in the coming years. “Competitive and exclusionary conducts look alike”, but we should not renounce any attempt to distinguish them.